Supreme Court, U. S.
FILED
JUL 6 1976
MICHAEL RODAK, JR., CLERK

IN THE

Supreme Court of the United States

No. 76-5

CHARLES E. MARSH and DETROIT BANK AND TRUST COMPANY, as Co-Trustees under the Trust of ALBERT and MINNIE MARSH,

Petitioners,

v.

ARMADA CORPORATION, JERRY D. LUPTAK, HERBERT S. EPSTEIN, LEONARD FRIEDMAN, WILBUR L. ROSS, JR., GEORGE S. PIERSON, ARTHUR E. CHAMBERS, JOHN E. PUVOGEL, ROBERT I. CRATCH, THOMAS S. TALMAN,

Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

PAUL M. BERNSTEIN
RONALD LITOWITZ
Attorneys for Petitioners
99 Park Avenue
New York, New York 10016

FRANK R. VECCHIO
Of Counsel

TABLE OF CONTENTS

	PAGE
Opinions Below	1
Jurisdiction	2
Questions Presented	2
Statutes and Rules Involved	3
Statement of the Case	3
REASONS FOR GRANTING THE WRIT:	
I—THE DECISION BELOW IS INCONSISTENT WITH THE LEGISLATIVE POLICY BEHIND SECTION 10(b) AND RULE 10b-5	6
II—THE DECISION BELOW CONFLICTS WITH DECISIONS OF ANOTHER CIRCUIT COURT	8
III—THE DECISION BELOW IS ERRONEOUS	14
Conclusion	17
Appendix A	1a
Appendix B	10a
Appendix C	29a
Appendix D	30a

TABLE OF CASES CITED PAGE

California Motor Transport Co. v. *Trucking Unlimited*, 404 U.S. 508 (1972) 14

Drachman v. *Harvey*, 453 F.2d 722 (2d Cir. 1972) (en banc) 12

Green v. *Sante Fe Industries*, CCH Fed. Sec. L. Rptr., 1975-1976 Decs., ¶ 95,447 (2d Cir. 1976) .8, 9, 10, 12, 13, 14, 16

Marshel v. *AFW Fabric Corp.*, CCH Fed. Sec. L. Rptr., 1975-1976 Decs., ¶ 95,448 (2d Cir. 1976) .8, 9, 11, 12, 13, 14

Mutual Shares Corporation v. *Genesco, Inc.*, 384 F.2d 540 (2d Cir. 1967) 14

Pappas v. *Moss*, 393 F.2d 865 (3d Cir. 1968) 7

Popkin v. *Bishop*, 464 F.2d 714 (2d Cir. 1972) 15, 16

Schlick v. *Penn-Dixie Cement Corporation*, 507 F.2d 374 (2d Cir. 1974) cert. denied, 421 U.S. 976 (1975) 16

Schoenbaum v. *Firstbrook*, 405 F.2d 215 (2d Cir. 1968) (en banc) cert. denied, sub nom. *Manley* v. *Schoenbaum*, 395 U.S. 906 (1969) 7, 12

Shell v. *Hensley*, 430 F.2d 819 (5th Cir. 1970) 7

Superintendent of Insurance v. *Bankers Life & Casualty Co.*, 404 U.S. 6 (1971) 7, 8

Travis v. *Anthes Imperial Ltd.*, 473 F.2d 515 (8th Cir. 1973) 7

Vine v. *Beneficial Finance Company*, 374 F.2d 627 (2d Cir. 1967), cert. denied, 389 U.S. 970 (1967) 14

Voege v. *American Sumatra Tobacco Corp.*, 241 F. Supp. 369 (D. Del. 1965) 14

Walker Process Equip., Inc. v. *Food Mach. & Chem. Corp.*, 382 U.S. 172 (1965) 14

STATUTES AND RULES CITED PAGE

Securities Exchange Act of 1934, Section 10(b) (15 U.S.C. § 78j(b)) 2, 3, 6, 7, 8, 12, 14

Securities Exchange Act of 1934, Rule 10b-5 (17 C.F.R. 240.10b-5) 2, 3, 6, 7, 8, 9, 10, 12, 13, 14, 15, 16, 17

28 U.S.C. § 1254(1) 2

Michigan Business Corporation Act:

Section 761(a) 5

Section 762(1) 5

IN THE

Supreme Court of the United States

No.

CHARLES E. MARSH and DETROIT BANK AND TRUST COMPANY, as Co-Trustees under the Trust of ALBERT and MINNIE MARSH,

Petitioners,

v.

ARMADA CORPORATION, JERRY D. LUPTAK, HERBERT S. EPSTEIN, LEONARD FRIEDMAN, WILBUR L. ROSS, JR., GEORGE S. PIERSON, ARTHUR E. CHAMBERS, JOHN E. PUVOGEL, ROBERT I. CRATCH, THOMAS S. TALMAN,

Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

Petitioners pray that a writ of certiorari issue to review a judgment of the United States Court of Appeals for the Sixth Circuit which affirmed a judgment of the United States District Court for the Eastern District of Michigan dismissing the complaint herein for failure to state a claim upon which relief could be granted.

Opinions Below

The opinion of the United States District Court appears as Appendix A. The opinion of the Court of Appeals appears as Appendix B and is reported at CCH Fed. Sec. L. Rptr., 1975-1976 Decs., ¶ 95,496 (6th Cir. 1976).

Jurisdiction

The decision of the Court of Appeals is dated April 5, 1976. A timely petition for rehearing, with suggestion for rehearing in banc, was denied by order dated May 7, 1976. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

Questions Presented

1. Does a complaint alleging violations of Section 10(b) of the Securities Exchange Act of 1934 ("the 1934 Act"), and Rule 10b-5 promulgated thereunder state a meritorious cause of action for damages when:

   (a) the complaint alleges a scheme to defraud that included a tender for 51% control of Hoskins Manufacturing Company ("Hoskins"), a public corporation, so that a merger could be promptly effected on terms grossly unfair to the remaining Hoskins shareholders when (a) a 51% vote was needed for approval on the merger vote, and (b) no appraisal right existed for such remaining shareholders;

   (b) the complaint alleges a false representation made by certain defendants during the tender that any subsequent merger between Hoskins and the tenderer, Armada Corporation ("Armada"), would be fair to Hoskins shareholders; and

   (c) the complaint alleges an undisclosed plan that preceded the tender to ultimately "squeeze out" minority shareholders of Hoskins on grossly unfair terms.

2. Does conduct that constitutes a breach of fiduciary duty also constitute a violation of Rule 10b-5 when

such conduct directly and specifically relates to a tender for shares, sale of shares and the exchange of Hoskins shares for Armada shares on a merger.

3. Did the conduct of defendants in (a) tendering for Hoskins shares, (b) omitting Hoskins' dividend payments after the tender and (c) forcing the merger of Hoskins with Armada on grossly unfair terms to the Hoskins minority constitute a Rule 10b-5 "scheme".

Statutes and Rules Involved

This case involves Section 10(b) of the 1934 Act, 15 U.S.C. § 78j(b), and Rule 10b-5 (17 C.F.R. § 240.10b-5) promulgated thereunder, which are set forth in Appendix C hereto.

Statement of the Case

The action, consolidating two cases, arises out of a two-step "squeeze out" of the public shareholders of Hoskins by Armada. The defendants are Armada and nine individuals who served on Hoskins board of directors. Six of the nine individual defendants were also affiliated with Armada.

The two steps were a cash tender of $20 for Hoskins shares made by Armada in June 1973 and the subsequent merger of Hoskins into Armada after the successful completion of the tender. The tender, the first step, is not challenged by these actions but the merger, the second step, is.* The relevant underlying facts are as follows:

As of June 1, 1973, Hoskins was an old-line manufacturer of custom quality alloys in the form of wire, strip and ribbon. Hoskins had a strong record of earnings stability and growth which was reflected in a 40-year his-

---

* Litigation by Hoskins to block the tender was unsuccessful.

tory of uninterrupted dividend payments. According to the Hoskins Prospectus—Proxy Statement issued in connection with the Hoskins-Armada merger ("Proxy Statement"), the Hoskins common shares traded in a range from $14⅝ to $20⅜ for the 18 months preceding the first Hoskins-Armada encounter.

On June 4, 1973 the critical course of conduct challenged herein commenced. On that date, Armada made a $20 cash tender for 725,000 Hoskins shares which represented 51 per cent of the outstanding Hoskins stock. The Hoskins management actively fought the tender but to no avail—by June 30, 1973 Armada had acquired slightly more than fifty per cent of Hoskins.

In the course of the tender, Armada indicated

(1) that if Armada was successful in gaining control of Hoskins, a merger of Armada and Hoskins would be contemplated; and

(2) Armada might reduce or eliminate the Hoskins dividends if control were acquired.

However, the notice of tender also stated that specific terms for such a merger were not then known and Armada further represented to Hoskins' shareholders in a letter dated June 19, 1973 during the tender period that:

> "If Armada acquires control of Hoskins, as stated in the tender offer, we will attempt to merge; and if we merge, we *believe that those Hoskins shareholders who retain their shares will be satisfied with the merger,* even if we should reduce or eliminate dividends and utilize the liquid resources for expansion and acquisitions, as stated in the tender offer." (Emphasis supplied.)

In August 1973, after the smoke settled from the tender, Armada exerted its newly-won control by placing six Armada persons on the nine-man Hoskins board. The following month, September 1973, the Hoskins dividend was omitted after 40 years of consecutive dividend payments and it was indicated that dividends would not be paid in the future. Following this announcement, and as a result thereof, the market price of Hoskins shares declined.

On December 18, 1973 the expected merger was announced. What was also announced that day were the not-to-be-believed terms. Armada, holding 52 per cent of Hoskins shares and needing a 50 per cent vote, announced a merger ratio of 1.27 Armada shares for each Hoskins share. The economic effect of this was that each Hoskins share would be forced to accept Armada shares having a December 17, 1973 market value of $9.25. The use of the word "forced" is literally correct since under the law of Michigan, which governed the merger, an appraisal right was not available since both Hoskins' and Armada's shares were listed on a national securities exchange.*

The Proxy Statement was issued on May 6, 1974 and on June 3, 1974, with Armada voting its shares for approval,

---

* Sections 761(a) and 762(1) of Michigan Business Corporation Act [M.C.L.A. 450.1761(a) and 450.1762(1)] provide as follows:

> "Sec. 761. Except as provided in subsection (1) of section 762 a shareholder of a corporation may dissent from any of the following corporate actions:
>
> '(a) Mergers or consolidations. A plan of merger or consolidation to which the corporation is a party, other than a plan pursuant to which shareholders receive cash, bonds or shares, or any combination thereof, if the shares satisfy the requirements of subsection (1) of section 762.
>
> "Sec. 762. (1) Unless otherwise provided in the articles of incorporation, a shareholder may not dissent as to any corporate action set forth in section 761 as to shares which are listed on a national securities exchange or are held of record by not less than 2,000 persons on the record date fixed to determine the shareholders entitled to receive notice of and to vote at the meeting of shareholders at which the corporate action is to be acted upon."

the merger was consummated on the terms announced on December 18, 1973.

The Complaint (Appendix D hereto) asserted claims on behalf of "all persons other than defendants, who owned common stock of Hoskins continuously between June 4, 1973 and December 18, 1973." This carefully defined class covers persons:

(a) who were eligible to accept the $20 tender, but chose not to do so;

(b) who, prior to the close of the tender period, were recipients of the Armada letter of June 19, 1973 promising them satisfactory merger terms; and

(c) who were forced to sell their Hoskins shares after the merger announcement at a depressed price in exchange for Armada shares at a grossly unfair ratio.

POINT I

The decision below is inconsistent with the legislative policy behind Section 10(b) and Rule 10b-5.

We respectfully urge that the Court below, while specifically treating the legislative intent of Section 10(b), misunderstood the intended scope of that section and Rule 10b-5 promulgated thereunder. The Court below at one point stated:

> "Although fraud by directors usually is also a breach of fiduciary duty, a breach of fiduciary duty in formulating the terms of a merger does not itself raise a Rule 10b-5 claim; to hold otherwise is to provide a federal forum for all shareholders dissatisfied with the terms of a proposed merger, which is not the intent of § 10(b) of the Exchange Act." (Appendix B, p. 22a).

Thereafter, in further discussing the intended scope of Section 10(b) the Court quoted from the Supreme Court in *Superintendent of Ins.* v. *Bankers Life & Cas. Co.*, 404 U.S. 6, 12 (1971) by stating:

> "Congress by § 10(b) did not seek to regulate transactions which constitute no more than internal corporate mismanagement. But we read § 10(b) to mean that Congress meant to bar deceptive devices and contrivances . . ." (Appendix B, p. 26a).

Significantly, the Court below stopped in mid-sentence and omitted the words:

> ". . . in the purchase or sale of securities whether conducted in the organized markets or face to face."

By so doing, the Court's decision obscured the basic point being made by the Supreme Court regarding the scope of section 10(b). That is that "internal corporate management", which includes issues such as salaries, dividend payments, corporate waste, conduct of business generally, are not issues within the range of the section or Rule 10b-5, but where the public is purchasing or exchanging shares and a transaction directly effecting such purchase or exchange is attacked as fraudulent the intention is to include such conduct within the Rule. Furthermore, courts have read Rule 10b-5 in this inclusive manner in the absence of a non-disclosure claim where self-dealing by corporate insiders has hurt the public where securities were sold or exchanged. Compare, *Schoenbaum* v. *Firstbrook*, 405 F.2d 215 (2d Cir. 1968) (en banc), cert. denied sub nom. *Manley* v. *Schoenbaum*, 395 U.S. 906 (1969); *Pappas* v. *Moss*, 393 F.2d 865 (3d Cir. 1968); *Shell* v. *Hensley*, 430 F.2d 819 (5th Cir. 1970); *Travis* v. *Anthes Imperial Ltd.*, 473 F.2d 515 (8th Cir. 1973).

Here, the alleged scheme directly and specifically affected the sale or exchange of Hoskins shares by purported class members and fits squarely within the type of transaction

this Court included within Rule 10b-5 by its discussion in *Bankers Life, supra.* The complaint here focused on what defendants did, not what they said, omitted to say or said in a misleading way. Defendants sought and gained 51% control of Hoskins by a tender so that they could force a merger on grossly unfair terms with full knowledge that a 51% vote assured such a merger and the absence of an appraisal remedy for the minority shareholders under the Michigan law, Hoskins' place of incorporation. To ignore this conduct and effect on the public, as the Court below does, creates the anomalous situation recognized by the Second Circuit recently in *Marshel* v. *AFW Fabric Corp.*, CCH Fed. Sec. L. Rptr., 1975-1976 Decs., ¶ 95,448 (2d Cir. 1976) wherein the Court stated:

> "Under these circumstances it would surely be anomalous to hold that a cause of action is stated under § 10(b) and Rule 10b-5 when the fraudulent conduct in connection with a purchase or sale of securities includes deception but that similarly fraudulent practices carried out with prior disclosure to the helpless victim do not give rise to a Rule 10b-5 claim. Neither the statutory language nor the broadly remedial purposes of the Act, see, e.g., Tcherepnin v. Knight, 389 U.S. 332, 336 (1967), allow such a distinction." (p. 99,271)

We respectfully urge that the clear intent behind section 10(b) and the specific language of Rule 10b-5 is sufficiently broad to include the course of conduct challenged herein.

POINT II

The decision below conflicts with decisions of another circuit court.

Two recent cases decided by the Second Circuit, *Green* v. *Santa Fe Industries,* CCH Fed. Sec. L. Rptr., 1975-1976 Decs., ¶ 95,447 (2d Cir. 1976) and *Marshel, supra* conflict

with the decision below.* This conflict is important because of the volume of Rule 10b-5 litigation before the courts and should be resolved.

Both *Green* and *Marshel* held breaches of fiduciary duty by control shareholders in merger cases were within the ambit of Rule 10b-5 absent a claim respecting the quality of the disclosure in the transaction.** Here conversely, the Court below immunized defendants' breach of duty from attack under Rule 10b-5 because of purported full disclosure.

The Court below framed the issues on appeal as follows:

> "We must therefore construe the shareholders' claim to be that when a party announces during a tender offer its intention to eliminate dividends of the company when acquired, and thereafter does so for the purpose of lowering the cost of a subsequent merger to itself, it has defrauded the shareholders." (Appendix B, p. 20a).

Then again:

> "Is an elimination of dividends for the purpose of lowering the market value of a stock prior to a merger actionable under Rule 10b-5 if the intent to eliminate dividends is announced publicly during the pendency of a tender offer? Stated another way, the question is whether manipulation of the market price of the stock by eliminating dividends, with prior full disclosure,

---

* The Court of Appeals denied en banc consideration in both cases, expressing the belief that certiorari would be granted in both. CCH Fed. Sec. L. Rptr., 1975-1976 Decs., ¶ 95,472.

** The Court in *Green* specifically found:
"Whether full disclosure has been made is not the crucial inquiry since it is the merger and the undervaluation which constitute the fraud, and not whether or not the majortiy determines to lay bare their real motives." (p. 99,251).

violates § 10b of the Exchange Act." (Appendix B, p. 17a).

In so stating the issues on appeal and then affirming dismissal of the complaint, the Court, in effect, ruled that a breach of fiduciary duty, accompanied by full disclosure, is not actionable under Rule 10b-5. Clearly, a majority shareholder (as Armada was after the tender) has a duty not to self-deal in a manner to favor itself in a transaction with minority shareholders. Elimination of dividends by a controlling shareholder to lower the price for Armada on the merger is, by any definition, self-dealing for Armada's own benefit and a breach of fiduciary duty.

In *Green,* the Court was faced with a short-form merger under Delaware law where no non-disclosure was asserted and the Delaware procedure itself was asserted as a violation of Rule 10b-5 in that it allowed the majority shareholder of Kirby Lumber Corporation to force minority shareholders, without prior notice and without a shareholder vote, to sell their stock to the majority holder at far less than its worth. The Court found the attack on the transaction did state a cause of action under Section 10(b) and clearly did so by stressing defendants' breach of duty to the minority in a transaction involving the exchange of their shares by stating:

> "The main thrust of the decision below is that to state a preliminary case under Rule 10b-5 there must be misrepresentation or lack of disclosure even in the presence of a breach of fiduciary duty. We disagree.
>
> • • •
>
> In Schoenbaum v. Firstbrook, 405 F.2d 215 (2d Cir. 1968) (en banc), cert. denied sub nom. Manley v. Schoenbaum, 395 U.S. 906 (1969), we focused on the question whether improper self-dealing and breach of fiduciary duty by the majority, without more, constituted a violation of 10b-5. Answering that question in the affirmative, Judge Hays, writing for the majority, emphasized subdivision (3) of 10b-5 and held that a preliminary cause of action under that Rule had been stated." (pp. 99,249 and 99,250)

The Court then went on to focus on the transaction and its impact on the minority shareholders by stating:

> "When controlling shareholders of a publicly held corporation use corporate funds to force extinction of the minority shareholders' interest for the sole purpose of feeding the pocketbooks of the controlling shareholders, such conduct goes beyond mere negligent mismanagement and is properly cognizable as 'an act, practice, or course of business which operates or would operate as a fraud • • •'. The majority has abused its equitable powers by exercising them for the 'aggrandizement, preference, or advantage of the fiduciary to the exclusion of the cestuis.' Pepper v. Litton, supra, at 311. See also Drachman v. Harvey, 453 F.2d 722, 736 (2d Cir. 1972) (en banc)." (p. 99,250).

In *Marshel,* plaintiff attacked a "going private" merger whereby a family that had taken advantage of public financing to "go public" then caused a merger to eliminate the minority stock interest at the expense of the corporate treasury when the market price for the corporation's shares had declined dramatically. The Court found:

> "The controlling shareholders of Concord have devised a scheme to defraud their corporation and the minority shareholders to whom they owe fiduciary obligations by causing Concord to finance the liquidation of the minority's interest with no justification in the form of a valid corporate purpose. The federal securities law does not confer jurisdiction for instances of corporate mismanagement or self-dealing absent fraud intrinsic to a securities transaction. Here, however, a purchase and sale of securities is at the heart of the

fraudulent scheme. See, e.g., Superintendent of Insurance v. Bankers Life & Casualty Co., supra at 10-13 (1971); Schlick v. Penn-Dixie Cement Corp., 507 F.2d 374, 379-80 (2d Cir. 1974), cert. denied, 421 U.S. 976 (1975); A. T. Brod & Co. v. Perlow, 375 F.2d 393, 397 (2d Cir. 1967); Ruckle v. Roto American Corp., 339 F.2d 24, 29 (2d Cir. 1964)." (p. 99,270).

The Court here stressed two factors that are equally applicable to the Hoskins merger—the fiduciary obligations Armada had after becoming a majority shareholder on the tender and the scheme's relation to the sale or exchange of Hoskins' shares after the dividend omission and announcement of the merger terms.

Both *Green* and *Marshel* found Rule 10b-5 violations where majority shareholders forced minority shareholders to accept mergers on unfair terms and which had no business purpose. The holdings of these cases center on the Rule 10b-5 coverage to breaches of duty, a type of wrongful conduct, in transactions directly affecting sales or exchanges of securities.*

In *Green* and *Marshel* the breach of duty may well have existed, in part, because of the lack of business purpose on the respective mergers. However, the key to the respective decisions is the breach of fiduciary duty in the merger context in which the breach arose, not the lack of business purpose. Compare *Schoenbaum, supra,* and *Drachman* v. *Harvey,* 453 F.2d 722 (2d Cir. 1972) (en banc), both relied upon in *Green* and *Marshel* and in which presence or lack of business purpose had no relevance to the breach of duty giving rise to the Rule 10b-5 claim sustained by the Court. Here, the Armada-Hoskins merger

* This is not to say, however, that all breaches of fiduciary duty arising where securities are sold or exchanged are violations of Rule 10b-5. That determination depends on whether the particular acts which constitute a breach are also within the broad areas of conduct proscribed by Rule 10b-5.

may have had some business purpose since, as the Court recognized "the merger was a true combining of two businesses." But, despite that fact, there was a breach of duty since Armada, as a controlling shareholder, acted to lower the cost to itself of the subsequent merger by eliminating dividends of Hoskins. This conduct constitutes a "device, scheme or artifice to defraud" and/or a "course of business which operates . . . as a fraud", conduct proscribed by subsections (1) and (3) of Rule 10b-5 when done in connection with the purchase or sale of a security.

The Court below tried to distinguish *Green* and *Marshel* on disclosure grounds stating:

> "In Green the Court stated that a transaction without notice to the shareholders should be subject to scrutiny under Rule 10b-5, and in Marshel the Court stated that 'fraudulent practices carried out with prior disclosure to a helpless victim' should call for a Rule 10b-5 remedy. In our case, the shareholders were not 'helpless victims' because they were told of the proposed dividend elimination at a time when they had an opportunity to sell their shares at a premium." (Appendix B, p. 25a)

The Court's retort to *Marshel* is without merit. The opportunity to sell at a premium was only available to 51% of the Hoskins shareholders. Armada quite obviously only paid the premium to gain the position and power to force the "squeeze-out" merger upon the Hoskins minority shareholders at a price well below the value of Hoskins shares.

In sum, the present case and *Green* and *Marshel* all raise issues about Rule 10b-5 liability where a controlling shareholder breaches its fiduciary duties to the minority in a merger context. *Green* and *Marshel* find a Rule 10b-5 claim stated by such breaches when done in connection with a merger which is a sale or exchange of securities regardless of the disclosure elements surrounding the

transaction. The Court below, while recognizing that Armada tried to economize on the merger by a self-dealing breach of fiduciary duty, immunizes the transaction from Section 10(b) coverage because of the blatant and brazen disclosure made by defendants. The two positions are in conflict and should be resolved.

POINT III

The decision below is erroneous.

Whether or not the decision below conflicts with that of the Second Circuit in *Green* and *Marshel,* review is appropriate since the decision represents an erroneously narrow and restrictive reading of Rule 10b-5 coverage of alleged multi-step schemes to acquire securities. This decision, when contrasted with the decisions in *Vine* v. *Beneficial Finance Company,* 374 F.2d 627 (2d Cir. 1967), cert. den. 389 U.S. 970 (1967); *Mutual Shares Corporation* v. *Genesco, Inc.,* 384 F.2d 540 (2d Cir. 1967) and *Voege* v. *American Sumatra Tobacco Corp.,* 241 F.Supp. 369 (D. Del. 1965), will undoubtedly be read as an emasculation of subparts (1) and (3) of Rule 10b-5 which, by their terms, seek to proscribe devious and fraudulent conduct.

The complaint alleged* a scheme that included among other things:

> "Planning, prior to the tender and throughout the merger, to get control of Hoskins so that a merger could be effected on terms grossly unfair to Hoskins' shareholders and dictated by Armada without recourse for Hoskins' minority shareholders;" (Complaint, paragraph 23(a), Appendix D, p. 37a).

---

* It is, of course, well established that for purposes of a motion to dismiss, the allegations of the Complaint are to be accepted as true. *Walker Process Equip., Inc.* v. *Food Mach. & Chem. Corp.,* 382 U.S. 172, 174-175 (1965); *California Motor Transport Co.* v. *Trucking Unlimited,* 404 U.S. 508, 515 (1972).

The Court, in its analysis thereof, has parsed the transaction to its finest elements and independently judged each. In so doing, the Court has isolated and sterilized the transaction and has not examined the facts as a single course of conduct to determine whether a "device, scheme or artifice to defraud" was employed. It is, of course, difficult to find fault in the following isolated elements:

—a tender by Armada for 51% control of Hoskins;

—an openly announced dividend omission;

—a letter issued in a tender fight that promises fair dealings in the future for non-tenderers;

—a merger based on existing market prices of the constituent companies.

However, when pieced together and considered as a totality in light of the lack of appraisal right for Hoskins' minority shareholders, the power of Armada with 51% control on the merger vote and the historical and intrinsic value of Hoskins shares, it is difficult to see a basis for finding defendants' conduct faultless in view of the broad scope of subparts (1) and (3) of Rule 10b-5. If defendants intended at the time of the tender, as the complaint alleges, to use the tender as a step in forcing a merger with an exchange ratio for the Hoskins minority shareholders at one-half of the tender price, defendants have engaged in a fraudulent scheme. The emphasis by the Court below on what words were misstated or omitted in the tender document, the letter or proxy statement, serves only to divert attention from the conduct of defendants that was deliberate, rapacious and fraudulent.

The lower court's reliance on *Popkin* v. *Bishop,* 464 F.2d 714 (2d Cir. 1972) is misplaced. *Popkin* was a derivative suit seeking to enjoin a merger based upon Rule 10b-5 where plaintiff specifically stipulated to the accuracy of the Proxy Statement issued in connection with the

merger. The Court denied the injunction but did recognize the broad application of Rule 10b-5 stating (p. 718):

> "Unquestionably this Court has recognized that Rule 10b-5 reaches beyond traditional stock transactions and into board rooms of corporations . . . We also recognize that assertions by a defendant that the misconduct complained of 'really' amounts to 'just' corporate mismanagement will not cut off a plaintiff's federal remedy."

Furthermore, in *Popkin* the Court made it clear that the case should not be read too broadly and that its holding was limited to the injunction context by stating (at p. 720, footnote 17):

> "We do not hold that failure to allege non-disclosure would itself justify dismissal of a complaint challenging a merger transaction under Rule 10b-5. But where it appears from the record that full and fair disclosure was made, or where, as here, appellant in cross motions for summary judgment was willing to concede that there was such disclosure, we think a Rule 10b-5 action for *injunctive* relief must fail." (Emphas supplied).

Furthermore, the Court of Appeals for the Second Circuit, the Court that decided *Popkin,* clearly reiterated *Popkin's* limited vitality to injunction cases only in *Schlick* v. *Penn-Dixie Cement Corporation,* 507 F.2d 374, 382 (2d Cir. 1974), cert. denied 421 U.S. 976 (1975). Also, see *Green, supra,* at p. 99,251, wherein the Court discusses *Popkin* and concludes that the reasoning of *Popkin* "impliedly supports" the *Green* decision.

In short, by emphasizing "disclosure" (subpart (2) of Rule 10b-5), to the exclusion of other elements, the Court below has effectively read subparts (1) and (3) out of the Rule.

We respectfully submit that, for reasons of policy and fairness to the small investor, this Court should send the message to every Circuit that all parts of Rule 10b-5 are very much alive.

Conclusion

The decision below presents important issues in the much litigated areas of the securities laws. The decision, by reason of the conflict it creates with the decisions of other circuits and because of its restricted reading of Rule 10b-5, should be reviewed by this Court. For the foregoing reasons, the petition for a Writ of Certiorari should be granted.

Respectfully submitted,

PAUL M. BERNSTEIN
RONALD LITOWITZ
Attorneys for Petitioners
99 Park Avenue
New York, New York 10016

FRANK B. VECCHIO
Of Counsel

Appendix A.

MEMORANDUM OPINION.*

UNITED STATES DISTRICT COURT
EASTERN DISTRICT OF MICHIGAN
SOUTHERN DIVISION

(Filed May 15, 1975)

Charles E. Marsh and Detroit Bank and Trust Company, as Co-Trustees under the Trust of Albert and Minnie Marsh,

Plaintiffs,

vs.

Armada Corporation, Jerry D. Luptak, Herbert S. Epstein, Leonard Friedman, Wilbur L. Ross, Jr., George S. Pierson, Arthur E. Chambers, John E. Puvogel, Robert I. Cratch and Thomas S. Talman,

Defendants,

Civil No. 4-71685

James S. Rothschild,

Plaintiff,

vs.

Armada Corporation, Jerry D. Luptak, Herbert S. Epstein, Leonard Friedman, Wilbur L. Ross, Jr., George S. Pierson, Arthur E. Chambers, John E. Pugovel, Robert I. Cratch and Thomas S. Talman,

Defendants.

Civil No. 4-71794

---

* As corrected by subsequent Order of Correction which remedied two typographical errors.

Appendix A.

This action may be considered as Phase II of the litigation involving the Armada Corporation, defendant herein, and the Hoskins Manufacturing Company, the defendant in Phase I. Phase I was an action brought by Armada as plaintiff against Hoskins for the purpose of obtaining injunctive relief with respect to certain activities of Hoskins in responding to a Tender Offer made by Armada for 725,000 shares of Hoskins stock. Said Tender Offer was made June 4, 1973. The Phase I complaint was filed June 4, 1973 and during the ensuing days of June 1973 the Court held 16 hearings involving various aspects of the proceedings attendant upon the Tender Offer. In Phase I defendant Hoskins counterclaimed seeking injunctive relief against continuance of Armada's Tender Offer. In its Order of June 26, 1973 this Court concluded that nothing had been presented to the Court (there was testimony adduced in court, deposition testimony, affidavits and substantial briefing) on which the Court could base a finding and conclusion that the Tender Offer was not a legitimate one. There was, therefore, no injunction issued against its continuance. Armada succeeded in purchasing 53% of Hoskins shares, thereby gaining control and subsequently effecting a merger of the two companies. The Tender Offer price was $20 a share, at a time when Hoskins was selling at $15-$15.75 a share on the American and Detroit stock exchanges. After Armada gained control of Hoskins, the regular dividend of Hoskins was omitted and it was announced that it would continue to be omitted (September 1973). In December 1973 announcement was made that Hoskins would be merged into a subsidiary of Armada, each share of Hoskins to be exchanged for 1.27 shares of Armada. At that time (December 17-18, 1973) Armada was trading at $7.00-plus. The exchange ratio, therefore, made Hoskins stock worth $9.00-plus. The merger was consummated June 3, 1974.

Appendix A.

Phase II Complaint has become a Joint Amended Complaint, brought by minority shareholders of Hoskins who did not tender their shares, against Armada and individual defendants who are or have been directors of Armada or Hoskins during the period relevant to this cause of action. The Joint Amended Complaint alleges that:

> Jurisdiction in this matter is predicated upon a federal question arising out of the violations of Section 10(b) of the Securities and Exchange Act of 1934 as amended [15 USC § 78J(b)] (hereinafter referred to as "Exchange Act"), and Rule 10b-5 promulgated thereunder in that defendants have, by use of instrumentalities of interstate commerce and the United States Mails, engaged in acts, practices and courses of conduct which constitute violations of the Exchange Act; and upon violations of the common law and the laws of the State of Michigan.

The Joint Amended Complaint is cast in three counts. Count I is based on an alleged violation of Section 10(b) of the Exchange Act and Rule 10b-5 promulgated thereunder. Counts II and III are non-federally based causes of action and are sustainable by virtue of pendent jurisdiction, if in fact federal jurisdiction exists as to Count I. Our inquiry, therefore, in determining defendants' Motion to Dismiss the Joint Amended Complaint hereinbefore filed, argued and briefed, is therefore directed to the Count I allegations of said Joint Amended Complaint.

It is the contention of plaintiffs that defendant Armada pursued a course of conduct culminating in the merger and the alleged unfair exchange ratio of 1.27 Armada shares for one Hoskins share, which constituted a violation of Section 10(b) of the Securities and Exchange Act of 1934, as amended (15 USC § 78j(b)). Said section reads as follows:

Appendix A.

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange— • • •
>
> (b) To use or employ, in connection with the purcase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

In Count I plaintiffs relate the details of the Tender Offer, including the statement in it that one of its purposes was to assume control of Hoskins and, if successful, to merge or consolidate Hoskins with Armada. Paragraph 13 of Count I reads as follows:

> During the course of the tender Armada communicated with Hoskins shareholders. Among the representations made by Armada was the following statement in a letter dated June 19, 1973 from Armada to Hoskins shareholders:
>
> "If Armada acquires control of Hoskins, as stated in the tender offer, we will attempt to merge; and if we merge, we believe that those Hoskins shareholders who retain their shares will be satisfied with the merger, even if we should reduce or eliminate dividends and utilize the liquid resources for expansion and acquisitions, as stated in the tender offer."

Count I recites that "[o]n or about August 10, 1973, Armada caused the six Armada defendants to be named to the nine-man Hoskins Board of Directors so that Armada could assume direct control over Hoskins." Continuing, Count I states that in September 1973 after assuming con-

Appendix A.

trol of Hoskins "Armada caused Hoskins to omit its regular dividend payment on its common shares and further announced that dividends would not be paid in the future on the Hoskins shares," the effect of which was to drive down the market price of Hoskins stock. Then on December 18, 1973 announcement was made of the merger and of the 1.27 exchange ratio. At this time Armada was being traded at $7.00-plus a share and Armada had sufficient voting power to consummate the merger.

Paragraph 22 of Count I reads as follows:

> Since June, 1973, the time of the tender by Armada for Hoskins shares, there have been no events adversely affecting Hoskins' business or otherwise justifying a merger with an exchange ratio of less than the $20.00 per share paid by Armada on the tender. On the contrary, Hoskins had record high earnings of $2.03 per share for fiscal 1973 and made a favorable acquisition of Brookfield Wire Company, Inc. on or about April 22, 1974.

It is plaintiffs' position that the acts of Armada as above described constituted the use of a "scheme to defraud class members by effecting the merger between Armada and Hoskins on grossly unfair terms to the Hoskins shareholders." As elements of the scheme plaintiffs allege, in the conclusion of Count I, the following:

> (a) planning, prior to the tender and throughout the merger, to get control of Hoskins so that a merger could be effected on terms grossly unfair to Hoskins' shareholders and dictated by Armada without recourse for Hoskins' minority shareholders;
>
> (b) falsely representing that any merger between Armada and Hoskins would be fair to Hoskins shareholders (Paragraph 13 above), when in fact, Armada intended from the time of the tender to

Appendix A.

merge Hoskins into Armada on grossly unfair terms for the Hoskins' shareholders;

(c) eliminating the Hoskins dividend for the purpose of depressing the market value of the Hoskins shares;

(d) structuring a merger ratio that was based upon Hoskins stock price when it was so artificially depressed; and

(e) failing to state in the proxy statement or elsewhere that Hoskins had very favorable prospects and expected increased earnings above the $2.03 per share earned in 1973.

In the brief in support of their Motion to Dismiss defendants contend that in moving to dismiss they "are not depriving plaintiffs of their right to litigate all the issues they assert here in state court, where admittedly Counts II and III belong, absent the alleged Federal question." (Brief in support of Motion to Dismiss Joint Amended Complaint, page 6.) It is defendants' contention that the alleged unfair merger ratio, the gravamen of plaintiffs' Complaint, "does not give rise to a federal question under the securities laws and the courts have held that such a question should be litigated in state courts." (Brief in support of Motion to Dismiss Joint Amended Complaint, page 7.) In conjunction with Section 10(b), Rule 10b-5 has been promulgated and it provides:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails, or of any facility of a national securities exchange,
>
> (1) to employ any device, scheme or artifice to defraud,

Appendix A.

> (2) to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or
>
> (3) to engage in any act, practice or course of business which operates or would operate as a fraud or deceit upon any person,
>
> in connection with the purchase or sale of any security.

Defendants' position is that there was no violation by them of Section 10(b) or of Rule 10b-5—no presence of the necessary elements of deception, causation, materiality and reliance.

Plaintiffs' reasoning is to the effect that the merger ratio was set without regard to the $20 Tender Offer, the market value of Hoskins during the one and a half years prior to the Tender Offer, and the earnings growth of Hoskins over the years. They contend that defendants, in effect, had planned the poor exchange ratio, had deliberately depressed the Hoskins stock for this purpose and had failed to make full disclosure of their "scheme." The reason why plaintiffs' theory of "scheme" is difficult to buy is that defendants did in fact, in the Tender Offer, announce clearly their intention to merge and did warn that the Hoskins dividend might be reduced or eliminated. Plaintiffs admit this. The Tender Offer offered $20 a share for Hoskins stock. It did not state that those not tendering could rely on that figure as one to be used in determining a subsequent exchange ratio. Those not tendering must be held to have been on notice that they would be taking their chances on what Hoskins stock would be worth after the consummation of the Tender Offer. They were informed clearly that the dividend might be eliminated. Even

the most unsophisticated investor knows what happens to market value when a dividend is passed. Was the tender offeror under an obligation to instruct the Hoskins shareholders as to such effect? We think not. The "scheme", if such there was, must be held to have been fully disclosed and to have been fully apparent. The fact that Armada represented that "we believe that those Hoskins shareholders who retained their shares will be satisfied with the merger * * *" can hardly be interpreted as a guaranty nor do we think that it can be fairly held to constitute deception or misrepresentation.

In *Popkin v. Bishop,* 464 F.2d 714 (2d Cir. 1972) the Court was asked enjoin a corporate merger on the ground of unfair exchange ratio. The Court there held:

> The fairness or unfairness of the exchange ratios is a complicated issue, but we do not believe that it must be resolved here. We are willing to assume that appellant is correct and that the exchange ratios are unfair. In addition, we agree that Equity's ability to push through the merger—with or without any other shareholder's vote—cannot by itself defeat a claim for federal injunctive relief. * * * [Citations omitted.] Having said all this however, we still conclude that appellant's action was properly dismissed.

At pages 719-720 of *Popkin v. Bishop, supra,* the Court stated as follows:

> Section 10(b) of the Exchange Act and Rule 10b-5 are designed principally to impose a duty to disclose and inform rather than to become enmeshed in passing judgments on information elicited. * * * [Citations omitted.] This design has special relevance to merger transactions that, under state law, must be subjected to shareholder approval. In the context of such transactions, if federal law ensures that shareholder approval is fairly sought and freely given, the principal federal interest is at an end. Underlying questions of the wisdom of such transactions or even their fairness become tangential at best to federal regulation.

In *Arber v. Essex Wire Corporation,* 490 F.2d 414 (6th Cir. 1974), an action brought to rescind a sale of stock by plaintiffs to *Essex,* Judge McCree, writing for the court, stated as follows, at page 421:

> Certainly developments *subsequent* to the 1961 sale greatly increased the value of the Essex stock and no doubt the Arbers' sale of their shares proved improvident by hindsight. But Section 10(b) does not require that an insider "confer upon outside investors the benefit of his superior financial or other expert analysis by disclosing his educated guesses or predictions." *Texas Gulf Sulphur Co., supra,* 401 F.2d at 848. In short, the law mandates disclosure only of existing material facts. It does not require an insider to volunteer any economic forecast.

Here, "developments" subsequent to the consummation of the Tender Offer caused the Hoskins stock to drop in market value and plaintiffs may well feel that their failure to tender their shares at the $20 figure "proved improvident by hindsight." The "developments," however, were entirely predictable on the basis of the information disclosed by defendants in the Armada Tender Offer.

It seems to the Court that the allegations contained in Count I are not such as to support a cause of action under Section 10(b) and Rule 10b-5 so as to confer jurisdiction on this Court. This being so, Counts II and III, sustainable only by virtue of pendent jurisdiction, must also fail.

An order of dismissal in accordance with the foregoing may be presented.

/s/ Thomas P. Thornton
United States District Judge

Appendix B.

No. 75-1885

UNITED STATES COURT OF APPEALS
FOR THE SIXTH CIRCUIT

CHARLES E. MARSH and DETROIT BANK AND TRUST COMPANY, as Co-Trustees under the Trust of ALBERT and MINNIE MARSH,
Plaintiffs-Appellants,

v.

ARMADA CORPORATION, JERRY D. LUPTAK, HERBERT S. EPSTEIN, LEONARD FRIEDMAN, WILBUR L. ROSS, JR., GEORGE S. PIERSON, ARTHUR E. CHAMBERS, JOHN E. PUVOGEL, ROBERT I. CRATCH, THOMAS S. TALMAN,
Defendants-Appellees.

APPEAL from United States District Court for the Eastern District of Michigan.

Decided and Filed April 5, 1976.

Before WEICK and LIVELY, Circuit Judges, and MARKEY,* Chief Judge, United States Court of Customs and Patent Appeals.

---

* The Honorable Howard T. Markey, sitting by designation.

Appendix B.

WEICK, Circuit Judge. This action is one of an increasing number of lawsuits in which minority shareholders, dissatisfied with the merger terms under which their stock is to be converted into cash or stock of the controlling corporation, seek a federal remedy by alleging violations of Section 10 (b) of the Securities Act of 1934 (hereinafter Exchange Act) and Rule 10b-5 promulgated thereunder.[1]

A common feature in this type of lawsuit is what is in reality a state law claim for unfairness or breach of fiduciary duty on the part of corporate officers and directors. Also common to this type of lawsuit is an alleged Rule 10b-5 claim which requires the court to explore the frontiers of statutory interpretation in order to ascertain whether federal question jurisdiction exists. Thus in dealing with the issues raised here we are not faced with the question whether the defendants' alleged wrongs call for a remedy, but only whether plaintiffs should have access to the federal courts as well as the state courts to seek the remedy.

In 1973 Armada Corporation made a written tender offer for shares of Hoskins Manufacturing Company, in which Armada sought to acquire up to 51% of the outstanding shares of Hoskins, and offered to pay therefor $20 per share. The market price of Hoskins shares at that time was $15 to $15.75 on the American and Detroit Stock Exchanges. Hoskins had paid regular quarterly dividends to its shareholders for forty years prior to the tender offer. The tender offer stated that Armada intended to merge Hoskins into Armada if Armada could gain control of Hoskins, and that Armada contemplated eliminating the dividend paid to Hoskins shareholders.

During the course of the tender offer Armada sent a letter to Hoskins shareholders which repeated the offer

---

[1] This trend is noted and reasons for it are discussed, in R. JENNINGS & H. MARSH, SECURITIES REGULATION 1223-30 (3d ed. 1972).

and then made the following statements:

> The Hoskins management wants you to believe that the tender offer will fail, yet their attorneys have argued in court for days that the Hoskins shareholders have the choice of tendering their shares now for $20 a share or take Armada stock. This is an admission that Armada will succeed; and they are right, we will win.
>
> If Armada acquires control of Hoskins, as stated in the tender offer, we will attempt to merge; and if we merge, we believe that those Hoskins shareholders who retain their shares will be satisfied with the merger, even if we should reduce or eliminate dividends and utilize the liquid resources for expansion and acquisitions, as stated in the tender offer.
>
> THE CHOICE IS YOURS—TENDER YOUR SHARES *NOW* FOR $20 A SHARE OR HOLD AND SEE WHAT HAPPENS.

The tender offer was successful; Armada purchased 53% of the outstanding Hoskins stock. In August, 1973 Armada elected six of the nine-man Hoskins Board of Directors. In September the board voted to eliminate Hoskins' quarterly dividend, and announced that dividends would not be paid in the future. In December the companies announced a proposed merger agreement in which Hoskins shareholders would receive 1.27 Armada shares for each share of Hoskins.

The market value of Hoskins and Armada shares had declined since the tender offer. In December Armada shares had a market value of $7.25 and Hoskins shares about $9.25. Thus Hoskins shareholders were to receive about $9.25 worth of Armada stock for each Hoskins share. In June, 1974 the merger was approved; under the laws of

Michigan only a majority of shares need approve a merger, and no appraisal rights existed in this case.

This class action was filed in the Eastern District of Michigan by several Hoskins shareholders in May, 1974 on behalf of all persons holding Hoskins shares continuously from the commencement of the tender offer through the announcement of the proposed merger terms.

The complaint contained three counts, seeking only damages: first, allegations that Armada had violated Rule 10b-5; second, allegations that the directors of Hoskins had breached their fiduciary duty to the shareholders; and third, allegations that the merger terms were unfair and oppressive. The last two counts were state law claims which the District Court declined to consider.

The District Court dismissed the action under Fed. R. Civ. P. 12 (b)(1) for failure to state a federal question, holding that federal interest in a tender offer or merger transaction under § 10 (b) of the Exchange Act ceases when it becomes apparent that the parties were fully informed of all material facts prior to the transaction, applying the rationale of *Popkin* v. *Bishop,* 464 F.2d 714 (2d Cir. 1972).

In an earlier phase of the case Hoskins sought to enjoin the merger but the District Court did not grant such relief. The validity of the merger is not in issue here.

In this appeal Hoskins shareholders argue that the expansive definition of fraudulent activities used by the courts in Rule 10b-5 cases includes conduct of the type encountered here. Specifically, they contend that Armada employed a fraudulent scheme to take control of Hoskins and then to drive down the value of Hoskins stock by omitting dividends so that Hoskins could be merged into Armada more cheaply.

The three acts within this scheme which the shareholders believe to be fraudulent are: 1) the statement in the letter during the tender offer that Hoskins shareholders will be satisfied with the merger terms; 2) the elimination of the dividend to lower the market value of Hoskins shares so that the merger could be accomplished with fewer Armada shares; and 3) the failure to state in the merger proxy statement that Hoskins expected to earn more in 1974 than it earned in 1973.

It will be necessary to examine each of these factors to determine whether this conduct is proscribed by Rule 10b-5. First, however, the question of standing must be considered.

I

STANDING

Armada claims that the complaint must be dismissed because the shareholders did not allege that they purchased or sold shares. Thus they have no standing to sue under Rule 10b-5 which prohibits fraud only in connection with the purchase or sale of a security. The *Birnbaum* rule,[2] recently approved in *Blue Chip Stamps* v. *Manor Drug Stores*, 421 U.S. 723 (1975), holds that a plaintiff in a Rule 10b-5 case has standing to sue only if a fraudulent activity caused him to buy or to sell stock. A person who claims that a fraudulent activity caused him to not buy stock which he otherwise would have bought, or to not sell stock which he otherwise would have sold, has no standing to sue under Rule 10b-5.

The basis of the rule is a policy determination that to permit suits by persons who claim inaction in reliance on fraudulent claims would open the door to vexatious and

---

[2] *Birnbaum* v. *Newport Steel Corp.*, 193 F.2d 461 (2d Cir.), *cert. denied*, 343 U.S. 956 (1952).

meritless lawsuits by persons who never owned stock but who comb the financial pages for possible inaccuracies which could support colorable claims with significant settlement value. Furthermore, the proof in such a lawsuit would consist of the plaintiff's unsupported testimony that he intended to purchase or sell a certain stock but that he did not do so after reading a certain report. In requiring a purchase or sale to occur, the *Birnbaum* rule seeks to support a claim of reliance by the fact that the plaintiff purchased or sold stock soon after an allegedly fraudulent act occurred.

The shareholders claim that the statement contained in the letter, ". . . we believe that those Hoskins shareholders who retain their shares will be satisfied with the merger . . ." caused them to retain their shares, to their loss, rather than sell or tender the shares to Armada, and that the statement was false and fraudulent. The shareholders have no standing to sue on this basis. This is the precise type of claim which the *Birnbaum* rule was intended to prevent, *i.e.*, the "reliance by inaction" claim.

The shareholders further claim that Armada fraudulently caused the value of the stock to drop; the question of standing to sue on this claim is more difficult. The exchange of shares in the merger certainly qualifies as a purchase or sale under the *Birnbaum* rule; *SEC* v. *National Sec., Inc.*, 393 U.S. 453, 467 (1969). Armada argues that the sareholders failed to allege that they sold or exchanged their stock. However, they did allege that the merger was consummated, and under the liberal rules of notice pleading this allegation is sufficient to meet the *Birnbaum* requirement of a sale, as were similar allegations in *Vine* v. *Beneficial Fin. Co.*, 374 F.2d 627 (2d Cir.), *cert. denied*, 389 U.S. 970 (1967).

In *Vine* the Court discussed the element of reliance and held that reliance need not be shown if the deception com-

plained of was directed at a third person. Armada argues that, unlike *Vine*, the fraud alleged here created no reliance at all; therefore the exchange of stock cannot be considered a sale for purposes of the *Birnbaum* rule, and the shareholders have no standing. *Vine* did not state that reliance must be alleged to gain standing. Only after disposing of the standing issue did the Court in *Vine* discuss reliance. The presence or absence of a sufficient allegation of reliance is a question addressing the sufficiency of the complaint, not the standing of the shareholders. Standing is established by allegations that plaintiffs bought or sold shares of the stock in question within a reasonable period of time after the allegedly fraudulent conduct occurred to support an inference of reliance.[3]

Since the shareholders here allege that the terms of the merger exchange were the result of a fraudulent scheme, and since a merger exchange constitutes a sale for purposes of standing, we find that the shareholders have standing to assert a claim that they were defrauded in the merger exchange. We therefore turn to the allegations of the complaint to determine whether the shareholders have sufficiently stated a claim for relief.

---

[3] Although the presence of reliance goes to the sufficiency of the complaint, standing is not accorded to a plaintiff if his purchase or sale occurs before the alleged fraudulent conduct, or after the alleged fraudulent conduct was exposed, as in *In re Penn Central Sec. Litigation*, 62 F.R.D. 181 (E.D. Pa. 1974), and *In re R. Hoe & Co.*, [1973-1974 Transfer Binder] CCH FED. SEC. L. REP. ¶ 94,552 (S.D.N.Y. 1974), because in such situations reliance clearly could not exist. *But see Voege* v. *American Sumatra Tobacco Corp.*, 241 F. Supp. 369 (D.Del. 1965) (purchase occurred fifteen years before alleged fraudulent conduct).

II

SUFFICIENCY OF THE COMPLAINT

We have already noted that the shareholders have no standing to claim that the letter contained a misrepresentation upon which they relied, since they did not purchase or sell in reliance on the letter. In *Vine* the Court held that a misrepresentation which caused a tender offer to be successful is actionable by those shareholders who did not tender but were forced to exchange shares in a subsequent merger.

Here the shareholders do not claim that the misrepresentation in the letter caused the tender offer to be successful, as they are not attacking the merger; rather, the only possible effect of the alleged misrepresentation would be to discourage shareholders from tendering their stock for five dollars more than the market value. Thus, they cannot claim that reliance by others upon the alleged misrepresentation caused their losses. Therefore they cannot show that anyone relied upon the alleged misrepresentation to their detriment, and we need not reach the question whether the letter contained a misrepresentation.

Turning to the allegation that Armada fraudulently manipulated the market price of Hoskins shares, we face the most significant question in this appeal: Is an elimination of dividends for the purpose of lowering the market value of a stock prior to a merger actionable under Rule 10b-5 if the intent to eliminate dividends is announced publicly during the pendency of a tender offer? Stated another way, the question is whether manipulation of the market price of the stock by eliminating dividends, with prior full disclosure, violates § 10 (b) of the Exchange Act.

Appendix B.

Section 10 (b) does not flatly prohibit the use of a manipulative device in the purchase or sale of a security; rather, it prohibits "any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the [SEC] may prescribe." Only those manipulative devices prohibited in SEC Regulations are unlawful under the Exchange Act.

The Regulations prohibit a number of specific manipulative devices, but none of them covers the situation here. Rule 10b-5, 17 C.F.R. § 240.10b-5, is a catchall provision to cover schemes not specifically prohibited in other provisions. Nevertheless, if the shareholders' claim does not fall within the language of Rule 10b-5 it is not actionable under § 10 (b) of the Exchange Act. Rule 10b-5 reads as follows:

> It shall be unlawful for any person, directly or indirectly, by use of any means or instrumentality of interstate commerce, or of the mails, or of any facility of a national securities exchange,
>
> (1) to employ any device, scheme or artifice to defraud,
>
> (2) to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or
>
> (3) to engage in any act, practice or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

The three prohibited activities listed in Rule 10b-5 share a common element, the element of fraud. The fraud prohibited in Rule 10b-5 is said to not be subject to the limita-

Appendix B.

tions of common law fraud.[4] The Supreme Court has stated that the elements of common law fraud have changed in Rule 10b-5 cases. *SEC* v. *Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 192-95 (1963) (intent to injure need not be proven when injunctive relief is sought). Subsection 2 of Rule 10b-5 is clearly inapplicable here because no actionable misrepresentation is presented in this case. The question thus becomes whether the alleged plan and conduct of Armada was fraudulent within the meaning of subsections 1 and 3 of the Rule.

No deception in regard to the manipulation of the market price of the stock is alleged here. Armada announced that it intended to eliminate the dividend and to merge the companies if its tender offer succeeded. This is precisely what occurred. Shareholders generally know that a company with a long history of dividend payments may face a short term drop in the market value of its stock when it announces the elimination of dividends, the drop being caused largely by the immediate desire to sell by many income-seeking investors holding that stock for its dividends. Confronted with this announcement during the tender offer, the shareholders knew they could tender for twenty dollars a share or risk the market effect of the elimination of dividends.

On the other hand, many shareholders, having faith in the merged company, might desire to exchange their Hoskins shares for Armada shares, hoping ultimately to enjoy

---

[4] *James* v. *Gerber Prods. Co.*, 483 F.2d 944, 946 (6th Cir. 1973). *See also Schlick* v. *Penn-Dixie Cement Corp.*, 507 F.2d 374, 378, n. 8 (2d Cir. 1974), where the Court suggests that in pleading under Rule 10b-5 particularity might not be required by Fed. R. Civ. P. 9 (b), because 9 (b) refers to common law fraud only. However, the further suggestion that subsection 2 of Rule 10b-5 refers to common law fraud seems untenable because the element of reliance need not be proven if a material omission is claimed under Rule 10b-5 (2).

a large increase in the value of their shares which they could sell and be taxed at capital gain rates.

We must therefore construe the shareholders' claim to be that when a party announces during a tender offer its intention to eliminate dividends of the company when acquired, and thereafter does so for the purpose of lowering the cost of a subsequent merger to itself, it has defrauded the shareholders.

The legal support for the shareholders' claim is found in *Mutual Shares Corp.* v. *Genesco, Inc.*, 384 F.2d 540, 546 (2d Cir. 1967), which construed two earlier cases to hold that "manipulation of the market price and purposeful reduction of dividends in order to buy out minority stockholders cheaply was actionable under Rule 10b-5." The Court then found a Rule 10b-5 claim based upon purposeful reduction of dividends, stating: "Deceitful manipulation of the market price of publicly-owned stock is precisely one of the types of injury to investors at which the Act and the Rule were aimed." 384 F.2d at 547. The deception in *Mutual Shares* arose because there was no disclosure of the intent or purpose of lowering dividends.

The two cases relied upon in *Mutual Shares* also require deception as a part of a dividend reduction scheme actionable under Rule 10b-5. In *Cochran* v. *Channing Corp.*, 211 F. Supp. 239 (S.D.N.Y. 1962), Channing embarked upon an unannounced program to acquire a company, in the course of which Channing caused the board of directors of the company to reduce its dividend. The plaintiff sold his shares when the price of the stock was depressed because of the dividend reduction and before the program was disclosed. When the program was disclosed the value of the stock rose. In finding fraud in the dividend reduction scheme the Court said:

> Fraud may be accomplished by false statements, a failure to correct a misleading impression left by statements already made or, as in the instant case, by not stating anything at all when there is a duty to come forward and speak. (*Id.* at 243).

In *O'Neill* v. *Maytag*, 339 F.2d 764, 768 (2d Cir. 1964), the Court cited *Cochran* to illustrate the proposition that deception can take the form of non-verbal acts, such as reducing dividends to drive down the price of a stock. However, *O'Neill* endorsed the need for allegations of deception:

> The question posed by this case is whether it is sufficient for an action under Rule 10b-5 to allege a breach of one of these general fiduciary duties where the breach does not involve deception. We think that it is not: At least where the duty allegedly breached is only the general duty existing among corporate officers, directors and shareholders, no cause of action is stated under Rule 10b-5 unless there is an allegation of facts amounting to deception.
>
> . . . .
>
> . . . [T]here must be allegation of facts amounting to deception in one form or another; conclusory allegations of deception or fraud will not suffice.
>
> (339 F.2d at 767-68).

Mutual Shares and *Cochran* held that deceptive schemes involving unannounced plans to reduce dividends were actionable under Rule 10b-5. The factual differences between those cases and the case at bar are crucial. Armada announced its intent to eliminate the dividends to Hoskins shareholders at a time when the shareholders had an opportunity to escape the consequences of the proposed action by selling their stock for a four dollar premium over market value. In *Mutual Shares* and *Cochran* nondisclosure of the intent to systematically lower dividends caused the

manipulation to be deceptive and prevented the shareholders from being able to protect their investment. Here we cannot find any action that deceived or defrauded the shareholders.

The Hoskins shareholders are in reality asserting that a dividend reduction accomplished for an improper purpose raises a Rule 10b-5 claim because such action is fraud per se. Certainly the directors of Hoskins have a duty to act in the best interest of the shareholders, so if the elimination of dividends was not in their best interest, the directors have breached that duty. However, we decline to equate a breach of fiduciary duty with fraud. Although fraud by directors usually is also a breach of fiduciary duty, a breach of fiduciary duty in formulating the terms of a merger does not itself raise a Rule 10b-5 claim; to hold otherwise is to provide a federal forum for all shareholders dissatisfied with the terms of a proposed merger, which is not the intent of § 10 (b) of the Exchange Act.

In *Popkin* v. *Bishop,* 464 F.2d 714 (2d Cir. 1972), relied upon by the District Court, the Second Circuit considered allegations that the exchange ratio offered in a merger was grossly inadequate, unfair, and constituted improper self-dealing which amounted to a fraud upon the shareholders because they would receive, as in this case, inadequate consideration for their stock. After noting that a full and fair disclosure of the merger terms had occurred, the Court said:

> Thus it seems clear that our emphasis on improper self-dealing did not eliminate non-disclosure as a key issue in Rule 10b-5 cases. Section 10(b) of the Exchange Act and Rule 10b-5 are designed principally to impose a duty to disclose and inform rather than to become enmeshed in passing judgments on information elicited [citations omitted]. This design has special relevance to merger transactions that, under state law,

> must be subjected to shareholder approval. In the context of such transactions, if federal law ensures that shareholder approval is fairly sought and freely given, the principal federal interest is at an end. Underlying questions of . . . fairness become tangential at best to federal regulation . . . . And when what is sought is injunctive relief, a federal court of equity should regard this consideration as controlling. Thus, in the present case, we believe that once appellant admitted that defendants fully and fairly disclosed all material facts surrounding the merger to all interested parties, including the minority shareholders, appellant's claim under Rule 10b-5 for injunctive relief must fail.
>
> (484 F.2d at 719-20).

In the recent case of *Green* v. *Santa Fe Industries,* No. 75-7256 (2d Cir. Feb. 18, 1976), the Court held that the use of a short form merger transaction to eliminate minority shareholders, without a legitimate corporate purpose, constitutes fraud per se. The Court noted that the short form merger statute being followed by Santa Fe required no notice to the minority, and that therefore it was important for the federal courts to scrutinize the transaction under Rule 10b-5 regardless of disclosure. In *Marshel* v. *AFW Fabric Corp.,* No. 75-7404 (2d Cir. Feb. 13, 1976), the Court reached the same conclusion on another "going private" merger transaction even though no allegation was made that notice was not given; in fact, in *Marshel* the Court assumed that prior disclosure had occurred, but stated that prior disclosure was irrelevant because the minority were helpless to stop the merger outside of the courts.[5]

---

[5] Judge Smith in a concurring opinion stated that he found it difficult to reconcile the holding of *Popkin* with the result of *Marshel.*

Appendix B.

The shareholders believe that *Green* and *Marshel* equate breach of fiduciary duty with fraud, and that unfair merger terms are therefore actionable under Rule 10b-5. In view of the fact that both decisions declined to overrule *Popkin*, we must construe the holding of these cases more narrowly. In *Green* the Court said:

> We hold that a complaint alleges a claim under Rule 10b-5 when it charges, in connection with a Delaware shortform merger, that a majority has committed a breach of its fiduciary duty to deal fairly with minority shareholders by effecting the merger without any justifiable business purpose. The minority shareholders are given no prior notice of the merger, thus having no opportunity to apply for injunctive relief, and the proposed price to be paid is substantially lower than the appraised value reflected in the Information Statement. We do not hold that the charge of excessively low valuation by itself satisfies the requirements of Rule 10b-5 because that is not the case before us.

Similarly, in *Marshel* the Court said:

> We hold that when controlling stockholders and directors of a publicly-held corporation cause it to expend corporate funds to force elimination of minority stockholders' equity participation for reasons not benefitting the corporation but rather serving only the interests of the controlling stockholders such conduct will be enjoined pursuant to Section 10 (b) and Rule 10b-5 . . . .

These two decisions cannot be read apart from the milieu of "going private" merger transactions. When a company goes public the purchasing shareholders become owners of the company for better or for worse; if the stock declines in

Appendix B.

value they expect that they will be able to choose to await better times and a higher price in the future. However, by using a merger device which is not really a merger, some corporations have caused these shareholders to lose their ability to await future benefits of ownership, while increasing the majority interest of the controlling shareholder at the expense of the corporation. The Second Circuit believed that *Popkin* was inapplicable to "going private" transactions, but did not hold or intimate that *Popkin* was inapplicable to a situation analogous to it.

We find that *Popkin* contains the more appropriate test to apply in this case; in comparing the facts of *Popkin*, *Green* and *Marshel* to the situation here, the similarity of *Popkin* cannot be ignored. In *Green* and *Marshel* the shareholders were attacking the merger itself as a fraud. In *Popkin* as here the shareholders do not attack the merger other than upon the fairness of its terms. In *Green* and *Marshel* the merger was a sham transaction designed to expropriate the ownership interests of the minority shareholders. In *Popkin* as here the merger was a true combining of two businesses, with the shareholders of both corporations obtaining interests in the surviving corporation. In *Green* the Court stated that a transaction without notice to the shareholders should be subject to scrutiny under Rule 10b-5, and in *Marshel* the Court stated that "fraudulent practices carried out with prior disclosure to a helpless victim" should call for a Rule 10b-5 remedy. In our case, the shareholders were not "helpless victims" because they were told of the proposed dividend elimination at a time when they had an opportunity to sell their shares at a premium; thus the impetus to distinguish *Popkin*, present in *Green* and *Marshel*, is absent here. We therefore conclude that when the shareholders allege that the terms of a merger are not only unfair but fraudulent but do not challenge the purpose of the merger they must

allege deception as required by Popkin.[6] The necessity to allege more than internal self-dealing and failure to act in the best interest of the shareholders was recognized by the Supreme Court in *Superintendent of Ins.* v. *Bankers Life & Cas. Co.*, 404 U.S. 6, 12 (1971):

> Congress by § 10(b) did not seek to regulate transactions which constitute no more than internal corporate mismanagement. But we read § 10(b) to mean that Congress meant to bar deceptive devices and contrivances . . . .

The shareholders' reliance upon *Schlick* v. *Penn-Dixie Cement Corp.*, 507 F.2d 374 (2d Cir. 1974), *cert. denied*, 421 U.S. 976 (1975), as indistinguishable from this case, is misplaced. *Schlick* quoted the passage from *Bankers Life, supra,* and then found that undisclosed manipulations of the market price of the stocks of companies preparing to merge constituted fraud under Rule 10b-5. *Schlick* thus merely proves the validity of the observation in *Popkin* that:

> [C]ases based upon Rule 10b-5 in which a court can properly find full and fair disclosure may not be frequent since self-dealing schemes and transactions are by nature secretive . . . . But when there has been such disclosure of a merger's terms, its [sic] seems unwise to invoke federal injunctive power, particularly

---

[6] We note that there is language in *James* v. *Gerber Products Co.*, 483 F.2d 944, 948 (6th Cir. 1973), which seems to state that unfair dealings are actionable under Rule 10b-5:

> A principal purpose of § 10 (b) and Rule 10b-5 is to protect purchasers and sellers of securities from those who deal unfairly with them.

However, since *James* involved nondisclosure of a material fact in a proxy statement, that case cannot be read to hold that allegations of unfairness are sufficient to state a Rule 10b-5 claim.

> since doing so might well encourage resort to the federal courts by any shareholder dissatisfied with a corporate merger.
>
> (464 F.2d at 720).

Returning again to the letter, we recognize that the shareholders have attempted to allege a deceptive scheme based upon misstatements in the letter. However, even if the statement in the letter did induce the shareholders to retain their stock, it cannot be considered a part of the scheme alleged.

Armada circulated the letter for the purpose of inducing tenders of Hoskins stock, not for the purpose of inducing shareholders to retain their shares. To argue that Armada intended to deceive the shareholders into retaining their shares is to ignore the fact that Armada's alleged scheme to lower the value of the stock could be served only by inducing sales of the stock by shareholders. The statement in the letter that the shareholders would be satisfied with merger terms can be interpreted in no way as part of a scheme to lower the value of the stock.

The shareholders also claim that the merger proxy statement was deceptive because it failed to state that Hoskins expected to achieve earnings in 1974 higher than it had earned in 1973. The failure to make a projection of future earnings of an acquired company in a merger proxy statement is not actionable under Rule 10b-5. In *Arber* v. *Essex Wire Corp.*, 490 F.2d 414, 421 (6 Cir. 1974), we stated:

> [T]he law mandates disclosure only of existing material facts. It does not require an insider to volunteer any economic forecast.

The SEC has addressed the problem of requiring disclosure of earnings forecasts in Exchange Act Release No.

Appendix B.

9984, 17 C.F.R. 241.9984 (Feb. 2, 1973), and has stated:

> The Commission has never required a company to publicly disclose its projections and does not intend to do so now. It has been the Commission's long standing policy generally not to permit projections to be included in prospectuses and reports filed with the Commission.

The SEC concluded that corporations should not be required to publicly state earnings projections, but that if they wished to do so the content of the projections would be regulated. This proposal was not extended to cover annual reports and proxy statements until April 28, 1975 in Exchange Act Release No. 11374. In that Release there was proposed an amendment to Exchange Act Reg. § 240.14a9 Note, which read:

> The following are some examples of what, depending upon particular facts and circumstances, may be misleading within the meaning of this rule:
>
> a. Predictions as to specific future market values, earnings, or dividuals.

The proposed amendment deletes the word "earnings" from the text of the Note; thus one of the major roadblocks to the use of earnings projections in proxy statements was removed; however, this proposal was issued Subsequent to the issuance of the proxy statement at issue here. We do not find any authority for the proposition that a failure to project higher earnings in a merger proxy statement is actionable under Rule 10b-5.

Because the shareholders have stated claims under which a court could find only violations of fiduciary duties and of state statutes prohibiting transactions unfair and oppressive to shareholders, the District Court lacked federal question jurisdiction, and properly dismissed the complaint.

Affirmed.

Appendix C.

Section 10(b) and Rule 10b-5.

Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b), provides:

> "Sec. 10. It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange—
>
> • • •
>
> "(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors."

Rule 10b-5 (17 C.F.R. § 240.10b-5) provides:

> "It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,
>
> "(a) To employ any device, schemes, or artifice to defraud,
>
> "(b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or
>
> "(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security."

Appendix D.

JOINT AMENDED COMPLAINT

UNITED STATES DISTRICT COURT
EASTERN DISTRICT OF MICHIGAN
SOUTHERN DIVISION

Charles E. Marsh and Detroit Bank and Trust Company, as Co-Trustees under the Trust of Albert and Minnie Marsh, Plaintiffs, vs. Armada Corporation, Jerry D. Luptak, Herbert S. Epstein, Leonard Friedman, Wilbur L. Ross, Jr., George S. Pierson, Arthur E. Chambers, John E. Puvogel, Robert I. Cratch and Thomas S. Talman, Defendants,	Civil Action No. 4-71685 Joint Amended Complaint Class Action
James S. Rothschild, Plaintiff, vs. Armada Corporation, Jerry D. Luptak, Herbert S. Epstein, Leonard Friedman, Wilbur L. Ross, Jr., George S. Pierson, Arthur E. Chambers, John E. Pugovel, Robert I. Cratch and Thomas S. Talman, Defendants.	Plaintiff's Demand a Jury Trial Civil Action No. 4-71794

(Filed July 31, 1974)

Appendix D.

Plaintiffs, by their attorneys, for their Joint Amended Complaint against defendants allege:

JURISDICTION AND VENUE

1. Jurisdiction in this matter is predicated upon a federal question arising out of the violations of Section 10(b) of the Securities and Exchange Act of 1934 as amended [15 USC § 78j(b)] (hereinafter referred to as "Exchange Act"), and Rule 10b-5 promulgated thereunder in that defendants have, by use of instrumentalities of interstate commerce and the United States Mails, engaged in acts, practices and courses of conduct which constitute violations of the Exchange Act; and upon violations of the common law and the laws of the State of Michigan.

2. Venue is properly laid in this district pursuant to the provisions of Sec. 27 of the Exchange Act (15 USC 78aa) and the principles of pendent jurisdiction in that the conduct complained of occurred in this district and the defendants are found, inhabit and transact business in this district as set forth in Sec. 27 of the Exchange Act (15 USC 78aa).

Parties

3. Plaintiffs described herein were minority shareholders of Hoskins Manufacturing Company, (hereinafter referred to as "Hoskins"), a Michigan corporation, and have held shares throughout the class period defined below. Plaintiffs are:

(a) Charles E. Marsh and Detroit Bank and Trust Company, Trustees under the Trust of Albert and Minnie Marsh, holding 36,000 shares;

Appendix D.

(b) James S. Rothschild, who bought 15 shares of Hoskins on March 14, 1962, which were subsequently split 3-for-1.

4. Defendant, Armada Corporation, (hereinafter referred to as "Armada") is a corporation organized and existing by virtue of the laws of the State of Michigan with its principal place of business in Detroit, Michigan. Armada is a corporation listed on the New York Stock Exchange and its stock is registered pursuant to Section 12 of the Securities Exchange Act of 1934 (15 USC 71 I) and is authorized to do business within this district. Armada, aside from its interest in Hoskins, is engaged principally in the business of manufacturing tallow and animal meal. Armada has been in the brewing business for approximately 40 years, but recently discontinued this aspect of its business.

5. Defendants Jerry D. Luptak, Herbert S. Epstein, Leonard Friedman, Wilbur L. Ross, Jr. and George S. Pierson at all times herein relevant were directors of Armada and became directors of Hoskins on or about August 10, 1973.

6. Defendant Arthur E. Chambers was named as a director of Hoskins on or about August 10, 1973, as a nominee of Armada. Defendant Chambers and the defendants referred to in paragraph "5" hereof are sometimes referred to collectively herein as the "Armada defendants."

7. Defendants John E. Puvogel, Robert I. Cratch and Thomas S. Talman at all times herein relevant were directors and officers of Hoskins.

Appendix D.

Class Action Allegations

8. Plaintiffs bring this action pursuant to Rule 23, Federal Rules of Civil Procedure (FR Civ P, 23) on their own behalf and as class representatives on behalf of the class of all persons, other than defendants, who owned common stock of Hoskins and continuously between June 4, 1973 and December 18, 1973. Plaintiffs further allege as follows:

(a) Plaintiffs do not know the number of members of the class. It is believed, however, that the number exceeds the number practical for joinder.

(b) Plaintiffs, who are members of the class, have sustained a loss and are committed to pursuing this action. Plaintiffs have retained competent counsel experienced in litigation of this nature. Accordingly, plaintiffs will fairly and adequately protect the interests of the class.

(c) The common questions relate to:

(i) Whether Armada and the individual defendants engaged in a scheme to defraud by planning, proposing and taking steps to effect a merger of Hoskins into Armada on terms grossly unfair to the class as defined herein.

(ii) Whether defendants acted affirmatively to depress the market price of Hoskins shares;

(iii) Whether defendants, during the period preceding the merger, failed to disclose adequately the extent of Hoskins's future profit prospects; and

(iv) Whether defendants breached a fiduciary duty to members of the class by proposing and

thereafter effecting the announced merger on the terms that were established.

(d) The likelihood of individual class members prosecuting separate actions is remote due to the relatively small loss suffered by each class member and the expense involved in prosecuting actions of this type.

(e) It is desirable to concentrate the litigation in this form since Hoskins and Armada are located within this district and substantially all discovery will be of persons and documents within the immediate vicinity of this district.

(f) No difficulties are anticipated in prosecuting the case as a class action.

Count I

1-8. Plaintiffs hereby reallege and incorporate by reference Paragraphs 1 through 8 of this Joint Amended Complaint in Count I.

9. On June 4, 1973, Armada published and circulated to the shareholders of Hoskins a Tender Offer, as amended June 11, 1973, offering to purchase up to 725,000 shares of the common stock of Hoskins, which was approximately 51 per cent of the then 1,410,711 outstanding shares. Hoskins was and is a successful old-line manufacturer of custom quality alloys in the form of wire, strip and ribbon.

10. Armada made a cash tender offer of $20.00 per share. Hoskins shares, which were publicly traded on the American and Detroit Stock Exchanges, had closed at between $15.00 and $15.75 during the five trading days before the tender.

11. The market price at which Hoskins stock was traded was supported by the fact that Hoskins paid regular quarterly dividends for approximately 40 years. During the period 1969 through 1973, Hoskins earnings per share and dividend payments on common stock were as follows:

	1969	*1970*	*1971*	*1972*	*1973*
Earnings Per Share	$1.39	$1.62	$1.45	$1.70	$2.03
Dividends	1.00	1.00	1.20	1.10	.75

12. The written tender stated, among other things, that the purpose of the tender was to assume control of Hoskins and that if Armada succeeded it would seek to merge or consolidate Hoskins with Armada.

13. During the course of the tender Armada communicated with Hoskins shareholders. Among the representations made by Armada was the following statement in a letter dated June 19, 1973 from Armada to Hoskins shareholders:

> "If Armada acquires control of Hoskins, as stated in the tender offer, we will attempt to merge; and if we merge, we believe that those Hoskins shareholders who retain their shares will be satisfied with the merger, even if we should reduce or eliminate dividends and utilize the liquid resources for expansion and acquisitions, as stated in the tender offer."

14. On or about June 30, 1973, Armada succeeded in its tender offer, acquiring slightly more than 50 per cent of the outstanding common stock of Hoskins.

15. The management of Hoskins had actively resisted the tender by Armada by recommending its rejection and

seeking an injunction in Federal Court. The District Court did not grant the injunction. An appeal was taken from the District Court holding, but the appeal was not heard on the merits since it was dismissed upon stipulation after the defendants had acquired majority control of Hoskins.

16. On or about August 10, 1973, Armada caused the six Armada defendants to be named to the nine-man Hoskins Board of Directors so that Armada could assume direct control over Hoskins.

17. In September, 1973, and after Armada assumed control of Hoskins, Armada caused Hoskins to omit its regular dividend payment on its common shares and further announced that dividends would not be paid in the future on the Hoskins shares. The direct and immediate effect of the termination of dividends was to drive down the market price at which Hoskins stock traded.

18. On December 18, 1973, it was announced that Hoskins would be merged into a subsidiary of Armada and on the merger each Hoskins shareholder would receive 1.27 shares of Armada for each Hoskins share then held.

19. On December 17, 1973, the day preceding the merger announcement, Armada traded at between $7\frac{1}{4}$ and $7\frac{3}{8}$, which meant each Hoskins share would be worth 1.27 Armada shares approximately $9.25 on the merger based on the most current Armada stock price.

20. On or about May 6, 1974, Hoskins issued a prospectus-proxy statement to its shareholders setting forth a plan of merger between Hoskins and Armada at the previously announced exchange ratio of 1.27 Armada shares for one (1) Hoskins share. The Hoskins

prospectus-proxy stated, among other things, that:

(a) Armada alone had sufficient voting power to cause the merger to be consummated even if all other Hoskins shareholders voted against the merger;

(b) That Hoskins shareholders had no appraisal rights.

21. On June 3, 1974, the merger was approved with Armada voting its shares for approval and the merger was consummated.

22. Since June, 1973, the time of the tender by Armada for Hoskins shares, there have been no events adversely affecting Hoskins business or otherwise justifying a merger with an exchange ratio of less than the $20.00 per share paid by Armada on the tender. On the contrary, Hoskins had record high earnings of $2.03 per share for fiscal 1973 and made a favorable acquisition of Brookfield Wire Company, Inc. on or about April 22, 1974.

23. In view of the foregoing, Armada and the Armada defendants have violated Section 10(b) of the Exchange Act and Rule 10 b-5 promulgated thereunder and damaged the class since they employed a scheme to defraud class members by effecting the merger between Armada and Hoskins on grossly unfair terms to the Hoskins shareholders. Elements of the scheme included:

(a) planning, prior to the tender and throughout the merger, to get control of Hoskins so that a merger could be effected on terms grossly unfair to Hoskins' shareholders and dictated by Armada without recourse for Hoskins' minority shareholders;

(b) falsely representing that any merger between Armada and Hoskins would be afir to Hoskins shareholders (Paragraph 13 above), when, in fact, Armada and Hoskins would be fair to Hoskins shareholders merge Hoskins into Armada on grossly unfair terms for the Hoskins' shareholders;

(c) eliminating the Hoskins dividend for the purpose of depressing the market value of the Hoskins shares;

(d) structuring a merger ratio that was based upon Hoskins stock price when it was so artifically depressed; and

(e) failing to state in the proxy statement or elsewhere that Hoskins had very favorable prospects and expected increased earnings above the $2.03 per share earned in 1973.

Count II

1-23. Plaintiffs hereby reallege and incorporate by reference Paragraphs 1 through 23 of this Joint Amended Complaint in Count II.

24. On information and belief, on or about December 27, 1973, defendants herein approved a plan of merger under which each Hoskins share held by the minority shareholders of Hoskins (and excluding those held by Armada) would be exchanged for 1.27 shares of Armada common stock.

25. The merger forced class members to exchange each Hoskins share for Armada shares having a market value of approximately $7.50 per share, or approximately $12.50 per share less than the $20.00 cash received by other Hoskins shareholders on the tender.

26. Armada as the controlling shareholder of Hoskins owed a fiduciary duty to Hoskins and all Hoskins' shareholders including class members as defined herein.

27. The individual defendants owed a fiduciary duty to Hoskins and all Hoskins' shareholders including class members as defined herein.

28. The plan of merger, as approved by the respective Board of Directors of Armada and Hoskins constitutes a breach of the common law fiduciary duty which the individual defendants and Armada owe the minority shareholders of Hoskins in that the defendants have knowingly forced the proposed merger on grossly unfair terms for the class members.

29. The plan of merger is a breach of the aforesaid fiduciary duties in the following respects:

(a) The exchange ratio of 1.27 shares of Armada for one (1) share of Hoskins, upon information and belief, was predicated on a market price of Hoskins shares on or about December 17, 1973, a date deliberately chosen because of the depressed price of Hoskins stock.

(b) The exchange ratio is unfair and oppressive to the minority shareholders of Hoskins for the reason that it is not predicated upon generally accepted principles utilized in evaluating shares of stock.

(c) The merger is an attempt to use the assets of Hoskins, directly or indirectly, to repay the indebtedness incurred by Armada to finance the tender offer which in effect causes the acquired company, Hoskins, to pay for the acquisition of Hoskins

by Armada. Such merger in no way benefits the minority shareholders of Hoskins and is a corporate raid of Hoskins assets, which assets are held in trust by the Directors for the benefit of creditors and shareholders of Hoskins and if used to pay Armada's debts, directly or indirectly, represents an unlawful diversion of said monies.

30. In addition to the aforesaid breach of fiduciary duties, defendants have knowingly engaged in a course of conduct to compel the aforesaid merger and squeeze out all other owners of Hoskins shares on terms grossly and knowingly unfair to the members of the class and thereby benefit themselves at the expense of the class members.

Count III

1-30. Plaintiffs hereby reallege and incorporate by reference Paragraphs 1 through 30 of this Joint Amended Complaint in Count III.

31. The plan of merger, as approved by the respective Board of Directors of Armada and Hoskins constitutes an illegal, fraudulent, unfair and/or oppressive action under Section 825 of the Michigan Business Corporation Act (MCLA 450.1825; MSA 21.200[825]), on the part of the individual defendants and Armada against the minority shareholders of Hoskins for the reasons set forth in Count II of this Joint Amended Complaint.

WHEREFORE, plaintiffs demand judgment against the defendants, jointly and severally, as follows:

(a) awarding plaintiffs and the class such compensatory damages, with interest, as have been sustained;

(b) awarding plaintiffs and the class exemplary damages;

(c) awarding plaintiffs reasonable counsel fees and fees for accountants, as well as the costs and disbursements incident to the prosecution of the action; and

(d) granting such other and further relief as may be just and proper

Milmet, Vecchio, Kennedy and Carnago, P.C.
By: Frank B. Vecchio
Attorneys for Plaintiff
Charles E. Marsh and Detroit Bank & Trust Co.
1400 First Nat'l Building
Detroit, Michigan 48226
(313) 961-7070

Sommers, Schwartz, Silver, Schwartz, Tyler & Gordon
By: Howard Silver
Attorneys for Plaintiff
James S. Rothschild
26555 Evergreen Road
1800 Travelers Tower
Southfield, Michigan 48076
(313) 355-0300
and
Kreindler and Kreindler
99 Park Avenue
New York, New York 10016
(212) 687-8181
Of Counsel

(60008)

Supreme Court, U. S.
FILED
AUG 3 1976
MICHAEL RODAK, JR., CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM, 1976

No. 76-5

CHARLES E. MARSH and DETROIT BANK AND TRUST COMPANY, as Co-Trustees under the Trust of ALBERT and MINNIE MARSH,
Petitioners,
v.
ARMADA CORPORATION, JERRY D. LUPTAK, HERBERT S. EPSTEIN, LEONARD FRIEDMAN, WILBUR L. ROSS, JR., GEORGE S. PIERSON, ARTHUR E. CHAMBERS, JOHN E. PUVOGEL, ROBERT I. CRATCH and THOMAS S. TALMAN,
Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

BRIEF FOR RESPONDENTS IN OPPOSITION

MURRAY C. MUNSHEN
DAVID E. CARY
Of Counsel

D. MICHAEL KRATCHMAN
Attorney for Respondents
2500 Buhl Building
Detroit, Michigan 48226

Interstate Brief & Record Co., 1615 Abbott St., Detroit, Michigan 48216
962-8745

TABLE OF CONTENTS

	Page
Table of Cases Cited	i
Question Presented	1
Statement	2
Argument:	
I. The Decision Below Is Consistent With The Legislative Policy of Section 10(b) and Rule 10b-5.	2
II. The Decision Below Does Not Conflict With Decisions of Another Circuit.	6
III. The Court Below Correctly Applied Section 10(b) And Rule 10b-5.	11
Conclusion	15

TABLE OF CASES CITED

Cases:

Affiliated Ute Citizens v. U.S., 406 U.S. 128 (1972)	3
Birnbaum v. Newport Steel Corp., 193 F.2d 461 (2d Cir. 1952), cert. denied, 343 U.S. 956 (1952)	4
Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723 (1975)	4
Ernst & Ernst v. Hochfelder, ___ U.S. ___, 96 S.Ct. 1375 (1976)	4,5,14
Green v. Santa Fe Industries, 533 F.2d 1283 (2d Cir. 1976), petition for cert. filed, 44 U.S. L. Week 3720 (U.S., June 2, 1976) (No. 75-1753)	6,9,10

Page

Marshel v. AFW Fabric Corp., 533 F.2d 1277 (2d Cir. 1976), petition for cert. filed, 44 U.S. L. Week 3720 (U.S., June 8, 1976) (No. 75-1782) 6,9,10

Mutual Shares Corporation v. Genesco, Inc., 384 F.2d 540 (2d Cir. 1967) 12

Popkin v. Bishop, 464 F.2d 714 (2d Cir. 1972) 5,7-9,11,13

SEC v. Capital Gains Research Bureau, 375 U.S. 180 (1963) 3

Vine v. Beneficial Finance Company, 374 F.2d 627 (2d. Cir. 1967), cert. denied 389 U.S. 970 (1967) 12

Statutes and Rules:

Securities Exchange Act of 1934, Section 10(b) (15 U.S.C. §78j(b)) 2-4,8,11,12

Securities Exchange Act of 1934, Rule 10b-5 (17 C.F.R. 240.10b-5) 2,4,5,8,11,12,14

IN THE

Supreme Court of the United States

OCTOBER TERM, 1976

No. 76-5

CHARLES E. MARSH and DETROIT BANK AND TRUST COMPANY, as Co-Trustees under the Trust of ALBERT and MINNIE MARSH,
Petitioners,
v.
ARMADA CORPORATION, JERRY D. LUPTAK, HERBERT S. EPSTEIN, LEONARD FRIEDMAN, WILBUR L. ROSS, JR., GEORGE S. PIERSON, ARTHUR E. CHAMBERS, JOHN E. PUVOGEL, ROBERT I. CRATCH and THOMAS S. TALMAN,
Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

BRIEF FOR RESPONDENTS IN OPPOSITION

QUESTION PRESENTED

DOES A COMPLAINT, WHICH DESCRIBES A SUCCESSFUL TENDER OFFER BY THE RESPONDENT CORPORATION ACCOMPANIED BY FULL DISCLOSURE AND A SUBSEQUENT MERGER, NOT CHALLENGED HEREIN AND ADMITTEDLY FOR A VALID BUSINESS PURPOSE, ON TERMS WHICH ARE ALLEGEDLY "GROSSLY UNFAIR", STATE A CLAIM FOR RELIEF UNDER SECTION 10(b) OF THE SECURITIES EXCHANGE ACT OF 1934?

STATEMENT

The facts of the case are adequately stated in the decisions of the District Court (Petitioners' Appendix A) and the Court of Appeals (Petitioners' Appendix B).

ARGUMENT

POINT I

The decision below is consistent with the legislative policy of Section 10(b) and Rule 10b-5.

Petitioners are asking this Court to change Section 10(b) of the Securities Exchange Act of 1934 ("Exchange Act") from a disclosure and anti-fraud provision to a provision requiring the Federal courts to investigate every corporate transaction involving a securities purchase or sale alleged to be "unfair". There is no Congressional or judicial support for this request. The Court below was correct in its interpretation of the scope of Section 10(b) and its analysis of the effect of the disclosure in the tender offer and subsequent actions of Armada Corporation ("Armada") on the market for the shares of Hoskins Manufacturing Company ("Hoskins"):

> "No deception in regard to the manipulation of the market price of the stock is alleged here. Armada announced that it intended to eliminate the dividend and to merge the companies if its tender offer succeeded. This is precisely what occurred. Shareholders generally know that a company with a long history of dividend payments may face a short term drop in the market value of its stock when it announces the elimination of dividends, the drop being caused largely by the immediate desire to sell by many income-seeking investors holding that stock for its dividends.

> Confronted with this announcement during the tender offer, the shareholders knew they could tender for twenty dollars a share or risk the market effect of the elimination of dividends.
>
> On the other hand, many shareholders, having faith in the merged company, might desire to exchange their Hoskins shares for Armada shares, hoping ultimately to enjoy a large increase in the value of their shares which they could sell and be taxed at capital gain rates." (Appendix B, 19a-20a)

* * * * *

"The necessity to allege more than internal self-dealing and failure to act in the best interest of the shareholders was recognized by the Supreme Court in *Superintendent of Ins.* v. *Bankers Life & Cas. Co.*, 404 U.S. 6, 12 (1971):

> 'Congress by §10(b) did not seek to regulate transactions which constitute no more than internal corporate mismanagement. But we read §10(b) to mean that Congress meant to bar deceptive devices and contrivances . . . .'" (Appendix B. 26a)

The basic philosophical premise and operational technique underlying the federal securities laws is disclosure. This Court has held that Congress intended, ". . . to substitute a philosophy of full disclosure for the philosophy of *caveat emptor* . . . ." *Affiliated Ute Citizens* v. *U.S.* 406 U.S. 128, 151 (1972); *SEC* v. *Capital Gains Research Bureau*, 375 U.S. 180, 186 (1963).

Recently, this Court discussed the origins, underlying philosophy, Congressional intent or lack thereof, and current policy considerations in construing Section 10(b) of the Exchange Act in *Blue Chip Stamps* v. *Manor Drug Stores*, 421 U.S. 723 (1975) and *Ernst & Ernst* v. *Hochfelder*, ___ U.S. ___, 96 S.Ct. 1375 (1976). Although the holding in *Blue Chip* simply affirmed the venerable purchaser-seller standing requirement of *Birnbaum* v. *Newport Steel Corp.*, 193 F.2d 461 (2d Cir. 1952), *cert. denied*, 343 U.S. 956 (1952), this Court examined the role of the federal courts in expanding civil remedies under Rule 10b-5, ". . . a judicial oak which had grown from little more than a legislative acorn," and held that new remedies should be left to Congress to fashion rather than to the courts. In *Blue Chip* this Court stated:

> "There has been widespread recognition that litigation under Rule 10b-5 presents a danger of vexatiousness different in degree and in kind from that which accompanies litigation in general." (739)

In *Ernst & Ernst* v. *Hochfelder, supra*, this Court held that the effect of certain acts on investors is not determinative of a violation of Section 10(b) thereby further construing the intent of Congress in enacting Section 10(b). The words of the statute are the starting point in every case involving construction of a statute. The meaning of the word "manipulative" in Section 10(b) was found by this Court to be:

> "Use of the word 'manipulative' is especially significant. It is and was virtually a term of art when used in connection with securities markets. It connotes intentional or willful conduct designed to deceive or defraud investors by controlling or artificially affecting the price of securities." (1384)

This Court held that Rule 10b-5 cannot be read more broadly than the statute.

> "The rulemaking power granted to an administrative agency charged with the administration of a federal statute is not the power to make law. Rather, it is 'the power to adopt regulations to carry into effect the will of Congress as expressed by the statute.' (citations omitted) Thus, despite the broad view of the Rule advanced by the Commission in this case, its scope cannot exceed the power granted the Commission by Congress under § 10(b)." (1391)

Petitioners do not challenge the tender offer by Armada (Petition, p. 3). The complaint is based "on what defendants did, not what they said, omitted to say or said in a misleading way." (Petition, p. 8). Thus, petitioners are admitting that their action is not founded on any defective disclosure by respondents.

Where there has been disclosure of all material facts, there cannot be "a device, scheme or artifice to defraud" or a "fraud or deceit" under Rule 10b-5, and where there is no such deception in connection with the securities transaction, particularly a merger, the Exchange Act does not permit the federal courts to become engaged in passing on the fairness or the wisdom of the underlying transaction. This rule was recently expressed in *Popkin* v. *Bishop*, 464 F. 2d 714 (2d Cir. 1972), and is entirely consistent with this Court's limitation of Rule 10b-5 actions to those in which the defendant has a mental state embracing intent to deceive, manipulate, or defraud. *Ernst & Ernst* v. *Hochfelder, supra*. Where full disclosure is made the intent to deceive described in *Ernst & Ernst* is absent and a valid claim for relief cannot be stated under Section 10(b). The decision of the Court below is in conformity with the decision in *Ernst & Ernst* and was therefore correct.

POINT II

The decision below does not conflict with decisions of another circuit.

The decision below is not in conflict with the decisions of the Second Circuit in *Marshel* v. *AFW Fabric Corp.*, 533 F.2d 1277 (2d Cir. 1976), petition for cert. filed, 44 U.S. L. Week 3720 (U.S., June 8, 1976) (No. 75-1782) and *Green* v. *Santa Fe Industries*, 533 F.2d 1283 (2d Cir. 1976), petition for cert. filed, 44 U.S. L. Week 3720 (U.S., June 2, 1976) (No. 75-1753), but is consistent with that Court's earlier decision in *Popkin* v. *Bishop*, *supra*, which decision was not overruled in *Green* or *Marshel*.

Both the *Marshel* and the *Green* cases involved attempts by majority shareholders to eliminate minority shareholders from any equity participation in the respective corporations by payment to them of cash for their shares, popularly called a "freeze-out". In both cases, it was either stipulated or not disputed and the Court found that *there was no valid corporate business purpose for the merger* in which the minority shareholders received cash for their shares. In the case before this Court, the petitioners, formerly shareholders of Hoskins are objecting to a merger in which they received common stock of Armada in a merger which was approved by a vote of the shareholders of both corporations. Thus, petitioners continued as equity participants in the merged corporate entity and were not subjected to a "freeze-out". Petitioners admit that the

merger of Hoskins with Armada was effected with a valid business purpose. They state:

> "Here, the Armada-Hoskins merger may have had some business purpose since, as the Court recognized, 'the merger was a true combining of two businesses'." (Petition, p.p. 12-13)

The business purposes were described in the prospectus-proxy statement issued by Armada in connection with the solicitation of the shareholders' vote to approve the merger as follows:

> "The reasons for the proposed merger of Hosmanco and Hoskins are to utilize more effectively the liquid resources of Hoskins for internal expansion and acquisitions, to reduce overhead expenses through more centralization of management, to eliminate unnecessary duplications and costs occasioned by the existence of two public listed companies, to achieve full consolidation of future earnings of the Company and Hoskins and to provide the former shareholders of Hoskins with stock which will be listed on the New York Stock Exchange."

In contrast to the petitioners' contention that a conflict between circuits exists, the decision below expressly followed the decision of the Second Circuit in *Popkin* v. *Bishop*, *supra*. The Court below stated:

> "We find that *Popkin* contains the more appropriate test to apply in this case; in comparing the facts of *Popkin*, *Green* and *Marshel* to the situation here, the similarity of *Popkin* cannot be ignored." (Appendix B, 25a)

In *Popkin* v *Bishop*, *supra*, the Court affirmed the dismissal of a complaint alleging a violation of Rule 10b-5 and seeking injunctive relief on the ground that the exchange ratio in the proposed merger agreement was unfair to the plaintiff and other minority shareholders of one of the companies to be merged. In *Popkin*, three subsidary corporations were to be merged into the parent corporation in exchange for the parent corporation stock upon the vote of the shareholders of the corporations involved. The parent corporation had sufficient voting power to cause adoption of the merger proposal. A proxy statement describing the merger terms and the affairs of the corporations had been disseminated to shareholders pursuant to the requirements of the Exchange Act.

Plaintiff, a shareholder in one of the merged corporations, sought to enjoin the merger of his corporation into the defendant parent corporation on the grounds that the merger ratio was unfair. There was no claim that defendants had deceived the plaintiff. The issue squarely presented to the Court was whether full and fair disclosure under the proxy rules was sufficient to preclude a cause of action under Section 10(b) and Rule 10b-5, even though the exchange ratio in the merger was unfair. The Court held:

> "The fairness or unfairness of the exchange ratios is a complicated issue, but we do not believe that it must be resolved here. We are willing to assume that appellant is correct and that the exchange ratios are unfair. In addition, we agree that Equity's ability to push through the merger — with or without any other shareholder's vote — cannot by itself defeat a claim for federal injunctive relief." (717, 718)

The majority opinions in both the *Marshel* and *Green* cases recognized the importance of these factors and expressly did not overrule *Popkin*. In *Green*, Judge Medina, speaking for the majority, said:

> "*Popkin* holds that the primary reason misrepresentation or lack of disclosure was required was that shareholder approval was necessary. In the context of such transactions, (i.e., those for which shareholder approval is required), if federal law insures that shareholder approval is fairly sought and fully (sic) given, the principal federal interest is at an end. 464 F. 2d at 720 (material supplied). The plain implication is that in cases such as the short-form merger, where no shareholder approval is required, there is no need for a showing of misrepresentation or lack of disclosure to make out a 10b-5 case." (1291, 1292)

and in *Marshel*, the Court distinguished *Popkin* stating:

> "*Popkin* is inapposite. There a derivative action was brought to enjoin a merger on the grounds that the exchange ratios for the conversion of the common stock of the merging corporations into the stock of the surviving corporation were "unfair" to plaintiff. 464 F. 2d at 717. The propriety of the merger itself was not challenged." (1282)

The central allegation in the case at bar, as in *Popkin*, is that the merger was effected on "grossly unfair terms". This allegation was rejected in *Popkin* and by the Court below.

The differences between *Green* and *Marshel* and the case at bar were succinctly set forth by the Court below:

> "In *Green* and *Marshel* the shareholders were attacking the merger itself as a fraud. In *Popkin* as here the shareholders do not attack the merger other than upon the fairness of its terms. In *Green* and *Marshel* the merger was a sham transaction designed to expropriate the ownership interests of the minority shareholders. In *Popkin* as here the merger was a true combining of two businesses, with the shareholders of both corporations obtaining interests in the surviving corporation. In *Green* the Court stated that a transaction without notice to the shareholders should be subject to scrutiny under Rule[4] 10b-5, and in *Marshel* the Court stated that 'fraudulent practices carried out with prior disclosure to a helpless victim' should call for a Rule 10b-5 remedy. In our case, the shareholders were not 'helpless victims' because they were told of the proposed dividend elimination at a time when they had an opportunity to sell their shares at a premium; thus the impetus to distinguish *Popkin*, present in *Green* and *Marshel*, is absent here. We therefore conclude that when the shareholders allege that the terms of a merger are not only unfair but fraudulent but do not challenge the purpose of the merger they must allege deception as required by *Popkin*." (Appendix B, 25a-26a)

Petitioners are incorrect in characterizing the Armada-Hoskins merger as a "squeeze out" claiming that the "opportunity to sell at a premium was only available to 51% of the Hoskins shareholders" (Petition, p. 13), because they overlook the fact that Hoskins shareholders could sell their shares on the American

Stock Exchange at prices equal to or greater ($20 3/8 per share) than the tender offer price ($20 per share) during the tender offer period from June 4, 1973 to June 30, 1973, and that Armada purchased all of the tendered shares, which equalled approximately 52.6% of Hoskins' outstanding shares, pursuant to the exercise of Armada's option to purchase additional shares in the tender offer.

Contrary to petitioners contention that the decision below conflicts with recent decisions of the Second Circuit, it is evident that the decision of the Court below followed the decision of the Second Circuit in *Popkin* v. *Bishop, supra*, and cannot be construed as conflicting with decisions of the Second Circuit.

POINT III

The Court below correctly applied Section 10(b) and Rule 10b-5.

It is clear that the Court below did not consider the acts, conduct and statements made by defendants to constitute fraud, either as deception or misrepresentation. While it is true that Rule 10b-5 covers acts as well as verbal and written statements, the acts covered can only amount to deception when they occur without appropriate disclosure. Nondisclosures are the acts aimed at by clauses 1 and 3 of Rule 10b-5. Petitioners miss this point entirely. An act can only be fraudulent when it misleads. If the act is accompanied by full disclosure, no one can be misled by the act. It is only when innocent parties purchase and sell securities without disclosure of the manipulation that Rule 10b-5 is violated. Concentrating on "acts" or "conduct" in a Rule 10b-5 claim is only the beginning of the inquiry. The basic question must be what was the defendants conduct and did such conduct take place without full disclosure. Only

where an act occurs without disclosure or pursuant to an affirmative misrepresentation can the "deception" required under Rule 10b-5 be found. The effect of a dividend elimination on the price of Hoskins' shares was, as the District Court pointed out below, within the knowledge of "even the most unsophisticated investor." (Appendix A, 7a, 8a)

Contrary to petitioners' claim that the decision below "will be read as an emasculation of subparts (1) and (3) of Rule 10b-5" (Petition, p. 14), the decision below is consistent with the decisions cited by petitioners and considered by the Court below, by requiring deception to state a valid claim under Section 10(b). The Court below held:

> "The legal support for the shareholders' claim is found in *Mutual Shares Corp.* v. *Genesco, Inc.*, 384 F.2d 540, 546, (2d Cir. 1967), which construed two earlier cases to hold that 'manipulation of the market price and purposeful reduction of dividends in order to buy out minority stockholders cheaply was actionable under Rule 10b-5.' The Court then found a Rule 10b-5 claim based upon purposeful reduction of dividends, stating: 'Deceitful manipulation of the market price of publicly-owned stock is precisely one of the types of injury to investors at which the Act and the Rule were aimed.' 384 F.2d at 547. The deception in *Mutual Shares* arose because there was *no disclosure* of the intent or purpose of lowering dividends." (Appendix B, 20a) (Emphasis supplied)

Unlike the circumstances and nondisclosures in *Vine* v. *Beneficial Finance Company*, 374 F.2d 627 (2d Cir. 1967), cert. denied, 389 U.S. 970 (1967) and *Mutual Shares*

Corporation v. *Genesco, Inc., supra*, in the case at bar, the very acts that are claimed to be a violation of Rule 10b-5 as being a scheme to effectuate a merger on unfair terms, including, the intention to merge Hoskins and Armada and to reduce or eliminate dividends on Hoskins stock in order to utilize the liquid resources for expansion and acquisitions, were explicitly and precisely disclosed in the tender offer as required by the tender offer provisions of the Exchange Act [(15 USC §§78m(d) and 78n(d and e)], at a time when Armada did not own any shares of Hoskins common stock. Although the number of shareholders of Hoskins who tendered their shares based on the prospect of elimination of dividends cannot be precisely shown, it must be assumed that many shares were tendered in full reliance on this stated intention. Furthermore, that statement and the other representations made in the tender offer were relied on by purchasers and sellers of shares of Armada and Hoskins stock and other persons interested in these corporations.

Petitioners' claim in conclusionary language in paragraph 23(b) of the complaint that the "defendants falsely represented that any merger between Armada and Hoskins would be fair, when in fact, Armada intended from the time of the tender to merge Hoskins into Armada on grossly unfair terms for the Hoskins' shareholders." However, even if the merger ratio was "unfair" or "grossly unfair", in the absence of deception, there is no valid claim alleged. Because the fairness or unfairness of the merger ratio is not subject to judicial scrutiny, any characterization of a merger ratio as fair or unfair must perforce be excluded from court review. *Popkin* v. *Bishop, supra*.

This Court decided that the scope of the subsections of Rule 10b-5 should not be extended in *Ernst & Ernst* v. *Hochfelder, supra*, and stated:

> "Thus, despite the broad view of the Rule advanced by the Commission in this case, its scope cannot exceed the power granted the Commission by Congress under §10(b) . . . . When a statute speaks so specifically in terms of manipulation and deception, and of implementing devices and contrivances — the commonly understood terminology of intentional wrongdoing — and when its history reflects no more expansive intent, we are quite unwilling to extend the scope of the statute to negligent conduct." (1391)

There is an available forum for the petitioners' attempt to assert a claim of breach of fiduciary duty in the Michigan state court where petitioners recently filed a lawsuit* based on the same underlying facts under consideration here and where the state law questions involving alleged breaches of fiduciary duty are currently being litigated.

Charles E. Marsh, et al v. *Armada Corporation, et al*, State of Michigan in the Circuit Court for the County of Wayne, C.A. No. 76-614-064-CZ, complaint filed May 4, 1976.

CONCLUSION

For the reasons set forth above, the petition for certiorari should be denied.

Respectfully submitted,

D. Michael Kratchman
Attorney for Respondents
2500 Buhl Building
Detroit, Michigan 48226

Murray C. Munshen
David E. Cary
Of Counsel